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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-1189

AMERICAN STANDARD INC.,
Petitioner,

v.

CRANE CO., *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioner American Standard Inc. ("Standard") prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered December 20, 1974 in a consolidated action brought by Standard and others against the respondent Crane Co. ("Crane") under § 16(b) of the Securities Exchange Act of 1934.

The District Court consolidated an action in which Standard was the sole plaintiff with two other actions brought against Crane under § 16(b) by the respondents Melvin Kritzler and Henry Abrams, each of whom alleges that he was a stockholder of Westinghouse Air Brake Company ("Air Brake") prior to its merger with Standard shortly before this action commenced, and seeks recovery on behalf of all former Air Brake stockholders as a class.

The respondents Edward J. Hanley, Edwin Hodge, Jr., Frank L. Magee, John A. Mayer, A. King McCord, G. Albert Shoemaker, Eric A. Walker, Lawrence E. Walkley, Jay V. Wilcox and Leslie B. Worthington are former directors of Air Brake and were third-party defendants in the Courts below.

Opinions Below

The opinion of the District Court granting partial summary judgment to Standard on the issue of liability and denying Crane's motion for summary judgment (Appendix C hereto) is reported at 346 F. Supp. 1153. The opinion of the Court of Appeals reversing the judgment of the District Court and remanding with instructions to dismiss the complaint (Appendix A hereto) is not yet published in the Federal Reporter.

Jurisdiction

The judgment of the Court of Appeals (Appendix B hereto) was entered on December 20, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Under this Court's decision in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), is a 10% stockholder who, within less than six months:

> (a) obtains confidential information about the issuer from certain of its directors and other representatives, including information about the issuer's forthcoming merger with another corporation,
>
> (b) purchases a large number of additional shares of the issuer's stock, and

(c) exchanges those shares, upon the merger, for shares of the merged company (thereby becoming a 10% stockholder of the latter),

entitled to summary judgment dismissing the merged company's claim under § 16(b) of the Securities Exchange Act of 1934 on the ground that the exchange of shares in the merger was not a "sale" or a "purchase" for purposes of that statute?

2. Even if the exchange of shares in the merger was not a "sale" or "purchase," is the insider who, immediately upon the merger, becomes a 10% stockholder of the merged company liable under § 16(b) when, six days after the merger and within six months after becoming a 10% stockholder of one of the merging companies, he sells his holdings in the merged company for cash?

Statute Involved

Section 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(a), requires certain reports to be filed by "every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 [15 U.S.C. § 78 *l*] of this title, or is a director or an officer of the issuer of such security . . . ."

Section 16(b), 15 U.S.C. § 78p(b), in pertinent part provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other

than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the [Securities and Exchange] Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Statement of Facts

This is an action brought to recover short-swing profits realized by Crane in equity securities of Air Brake before its merger with Standard, and in equity securities of the merged company thereafter. This action was commenced shortly after the conclusion of the trial of two other actions between the same parties arising out of the same subject matter, and is based primarily on the record of that prior litigation.[1]

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[1] The record in the present case incorporates stipulated portions of the records in *Crane Co.* v. *Westinghouse Air Brake Company, et al.* (S.D.N.Y. No. 68 Civ. 1560), *Crane Co.* v. *American Standard, Inc. et al.* (S.D.N.Y. No. 68 Civ. 1845), and *Crane Company* v. *Westinghouse Air Brake Company, et al.* (Common Pleas, Allegheny County, Pa., No. 244, April Term 1968). Nos. 1560 and 1845 were consolidated for trial.

In the decision below, the Court of Appeals turned aside (without ruling upon) Crane's belated contention that the record in this case should not be deemed to include the records of these other cases, and many statements in the opinions of both the Court of Appeals and the District Court reflect their reliance on those records. See e.g., 10a-12a, 23a-24a; 43a, 51a. Crane itself agreed to the contents

In June 1967 Crane began to acquire large quantities of Air Brake shares on the stock market. When it had accumulated a substantial position, its chief executive officer, T. M. Evans, approached the Air Brake board of directors with a merger proposal, which eventually was rejected. Evans nevertheless continued to press Air Brake to merge with Crane, sought Crane representation on the Air Brake board, urged changes in Air Brake's accounting methods and engaged the Air Brake management in discussion of many other aspects of Air Brake's affairs.[2] In these discussions, Evans repeatedly emphasized that Crane had become Air Brake's largest stockholder.[3]

Crane continued to purchase Air Brake stock until, early in January 1968, it held a fraction less than 10%. At that point, obviously reluctant to subject itself to § 16(b) and other legal restrictions, it stopped buying. This decision was quickly changed, however, when Crane obtained word from inside sources that Air Brake was considering a merger.[4] This dramatic news, which Crane learned some six weeks before the public did, caused it to return at once to the market, and by January 26, 1968 it held more than 10% of Air Brake's outstanding shares.[5]

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of the record both in a series of stipulations and in a formal application by which it asked the Court of Appeals, following an appeal in one of the related cases, to retain the record in that case for use on the present appeal.

There appear in this Petition three forms of references to the record. For example: "45a" refers to the appendices to this Petition; "Ct. App. A. 127" refers to the joint appendix before the Court of Appeals; "2461 R." or "1560 R." or "244 R." refer to portions of the record which were not printed in the joint appendix before the Court of Appeals.

[2] See the Schedule of Crane's Contacts with Air Brake and Standard, pp. 25-30, *infra;* see also 2461 R. 87(9), Ex. 21; 2461 R. 87(3) pp. 17-19; 2461 R. 87(2) pp. 49-50.

[3] Ct. App. A. 239, 249.

[4] Ct. App. A. 215-217, 219-220, 135.

[5] Ct. App. A. 215-217, 127-135.

Approximately a month before Crane became a 10% stockholder, Air Brake had begun private merger discussions with Standard. In December 1967 Standard made preliminary inquiries about a possible merger, and on January 22, and February 7, 1968 the Air Brake board authorized detailed studies of such a merger.[6] On February 19, Standard made its first specific merger proposal, valuing Air Brake at $50 per share. Air Brake's stock was then selling at about $37 on the New York Stock Exchange.

On the following day, four of the Air Brake directors met to consider Standard's proposal. One of them, John A. Mayer, produced charts detailing Standard's markets, sales records and profit margins, and argued that Standard's line of business was no more attractive than Crane's.[7] Nevertheless, the other three directors were impressed with the high valuation offered for Air Brake stock and authorized the president to proceed with negotiations.[8]

Three days later Mayer divulged the proposed merger terms to Evans.[9] Mayer was clearly sympathetic to Crane's position; he not only opposed Air Brake's merger with Standard, but supported Crane's attempt to put its representatives on the Air Brake board and may well have considered that Crane, as Air Brake's largest stockholder, was entitled to know of important developments affecting the company. In any event, there is no dispute about the fact that on February 23 Mayer gave Evans advance knowledge of the merger proposal at $50 per share, for Evans himself expressly admitted receiving this information.

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[6] 2461 R. 87(1) p. 221-226.

[7] 2461 R. 98 pp. 15-16; 2461 R. 87 (1) p. 256-260.

[8] Ct. App. A. 203. The events leading up to the merger are narrated by the Court of Appeals in a related case, *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787, 802-803 (2d Cir. 1969); see also *Crane Co.* v. *American Standard, Inc.*, 490 F.2d 332 (2d Cir. 1973).

[9] Ct. App. A. 248-249.

Following this conversation with Mayer, Evans embarked at once on a series of discussions with other Air Brake directors. The record shows that Evans and other Crane officials had at least 11 separate, identifiable meetings or telephone discussions with Air Brake directors and representatives between February 23 and the end of May, during which period Crane remained a 10% stockholder of Air Brake.[10] Through these discussions—and undoubtedly many others that the record does not reflect—Crane obtained confidential information about Air Brake's consideration of alternative merger possibilities, impending changes in Air Brake's top management, the obsolescence of Air Brake's inventories and the extent to which Air Brake's stock was disbursed among many small stockholders.[11]

On March 1, 1968, the week before the first public announcement of the merger, Evans sent a telegram to Air Brake's chairman, stating:

> "We are advised that you have been negotiating a merger or sale of Westinghouse Air Brake Company. . . . Request that you and your directors make no commitment with respect to merger proposals involving other companies without first giving Crane Co. *your Company's largest stockholder* the opportunity to make a counter proposal that would be more favorable to all [Air Brake] stockholders. . . ."[12] (Emphasis added)

On March 4, 1968, Air Brake and Standard publicly announced their agreement to merge, subject to the approval of the stockholders of both companies at meetings scheduled for May 16. Far from ending its interest, this

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[10] See Schedule of Contacts, pp. 29-30, *infra*.

[11] Ct. App. A. 219-220, 144-145; 2461 R. 87 (10), Ex. 20.

[12] 2461 R. 87(9), Ex. 26.

announcement brought about a sharp increase in Crane's purchases of Air Brake stock. Having bought 43,200 shares in December, 41,500 in January and 29,400 in February, it bought 165,400 in March and then—through a tender offer—536,245 in April and 278,978 in May[13] Its last purchase, a block of 180,374 shares, was made on May 24, 1968, eight days after the Air Brake stockholders had cast their ballots on the merger proposal. The Air Brake stockholders approved the merger by a vote of nearly 2 to 1.

On June 7, 1968, when the merger became effective, all of Air Brake's outstanding stock was exchanged, on a 1-for-2 basis, for a new issue of convertible preference stock of the merged company, which continued business under Standard's name. Since Crane elected not to exercise its statutory appraisal rights, it received 740,311 shares of preference stock—or about 36% of the total issue—in exchange for its 1,480,623 Air Brake shares. Crane's 740,311 preference shares gave it the immediate and unconditional right to acquire more than 10% of the merged company's common stock.[14]

On June 13, 1968, six days after the effective date of the merger and less than five months after it had become a 10% stockholder of Air Brake, Crane voluntarily sold 730,311 of its 740,311 preference shares on the New York Stock Exchange in a single cash transaction, receiving a price equivalent to approximately $52.12 per Air Brake share.[15] During the period in which it was a 10% stockholder, Crane's Air Brake shares had been purchased at cash prices between 36⅞ and 44. The shares acquired through

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[13] Ct. App. A. 134-138. Through its tender offer, Crane sought to acquire Air Brake stock in exchange for a package of Crane debentures. The prospectus by which this offer was made did not disclose the fact that for months Crane had been receiving confidential information about Air Brake from inside sources.

[14] Ct. App. A. 117-118.

[15] Ct. App. A. 119-125.

its tender offer were in exchange for Crane debentures having a face value of $50 per Air Brake share.

The Proceedings Below

This action was commenced on June 17, 1968, two weeks after the conclusion of the trial in a related action between the same parties. Following the Court of Appeals' decision in the earlier action, *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d, 787 (2d Cir. 1969),[16] Crane moved for summary judgment in the present case, its motion being predicated on the sole ground that "the findings of the Court of Appeals . . . are dispositive of this action and entitle Crane to summary judgment. . . ." Standard cross-moved for summary judgment on the issue of liability alone, taking the position that Crane's liability was established by the record of the earlier action.[17]

The District Court, on October 12, 1971, granted Standard's motion and denied Crane's. One day later the Court

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[16] In that decision the Court rejected Crane's claims that the Air Brake proxy statement had been deficient and that Standard had engaged in unlawful proxy solicitation and "vote buying", and this Court subsequently denied Crane's petition for certiorari. 400 U.S. 822 (1970). In the same decision the Court of Appeals also held that certain transactions by Standard on a single day four weeks before the Air Brake stockholders' meeting called to vote on the merger had violated §§ 9(a) and 10(b) of the Exchange Act, and remanded to the District Court for a determination of whether Crane had suffered any injury from these transactions and what remedy, if any, should be decreed. The ensuing proceedings in the District Court are still in progress.

[17] Pursuant to Rule 9(g) of the District Court's rules, Crane and Standard both submitted statements of contested and uncontested facts that were, of necessity, framed in accordance with the limited contention found by Crane's original motion—*i.e.*, that the Court of Appeals' 1969 decision was "dispositive" of the case. Crane later raised much broader contentions, which the District Court considered (and rejected) even though Crane made no amendment to its statement under Rule 9(g). Since Crane had made no such amendment, Standard had no occasion to amend its own statement.

of Appeals handed down its decision in *Abrams* v. *Occidental Petroleum Corp.*, 450 F.2d 157 (2d Cir. 1971), and the District Court withdrew its opinion so as to determine whether *Occidental* required a different disposition in the present case. On July 6, 1972, following additional briefing, the District Court refiled its original opinion, together with a supplemental opinion holding that the Court of Appeals' decision in *Occidental* was not controlling.

Fifteen months later, following this Court's affirmance in *Occidental*, Crane applied for and was granted permission to take an interlocutory appeal, and on December 20, 1974 the Court of Appeals reversed and remanded with instructions to dismiss the complaint, holding (1) that the *Occidental* decision compelled the conclusion that Crane's exchange of stock in the merger was neither a "sale" of its Air Brake shares nor a "purchase" of its shares in the merged company, in spite of substantial evidence that Crane, unlike Occidental, had many opportunities to obtain, and in fact did obtain, confidential information about Air Brake during the four and a half months in which it was a 10% stockholder; and (2) that Crane's voluntary cash sale of the securities of the merged company six days after the merger did not result in § 16(b) liability because § 16(b) applies only to purchases and sales of securities of the "same" issuer, and Air Brake and the merged company were "different" issuers.

Why the Writ Should Be Granted

At a time when tender offers for corporate control have become commonplace,[18] the Court of Appeals for the Second

[18] During its fiscal years 1970 and 1971 alone, the Securities and Exchange Commission examined 77 tender offers filed under the Williams Act. Aranow & Einhorn, *Tender Offers for Corporate Control*, p. v (1973).

Circuit has rendered a decision that will have a major impact on virtually all such offers. By effectually immunizing those making tender offers from § 16(b), even when the offer has been made by a 10% stockholder shown to have had access to inside information and indeed to have actually obtained such information, the Court below has sharply limited the protection that this statute was intended to provide for the securities markets in general and the public stockholders in particular.

I.

While purporting to follow this Court's decision in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), the Court below has in fact turned that decision on its head.

In *Occidental*, this Court held that the application of § 16(b) to corporate mergers and other "unorthodox" or "borderline" transactions is to be determined, not by a flat rule, but on the basis of whether the particular transaction "may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to inside information . . ." 411 U.S. at 594. As Mr. Justice Douglas noted in his dissenting opinion, the *Occidental* rule calls for the courts to make "an *ad hoc* analysis of each transaction, determining both from the economics of the transaction and the *modus operandi* of the insider whether there exists the possibility of speculative abuse of inside information." 411 U.S. at 612.

In *Occidental*, unlike the present case, there was no claim that inside information had in fact been available; liability was asserted to flow automatically from the defendant's 10% stock ownership in old Kern and its alleged purchase and sale of old Kern securities within six months. Occi-

dental had committed itself to its last purchase only one day after becoming a 10% stockholder and it was obviously unlikely that inside information had been available to it during that brief interval, especially since old Kern's management refused to discuss with Occidental the subject of a merger or, apparently, any other subject. 411 U.S. at 596-600. After a detailed analysis of these and other facts presented by the record of that case, this Court concluded that the chance of Occidental's having had the requisite "access to inside information" was "extremely remote," 411 U.S. at 598, and accordingly ruled that no liability should attach in that case.

Here, in contrast, the record plainly shows that Crane *did* have access to inside information. During most of the four and a half months in which Crane was a 10% stockholder of Air Brake, Crane's officials were in almost constant contact with the Air Brake management, its directors and its employees, and in consequence Crane, as Air Brake's largest stockholder, had abundant opportunity to obtain confidential information that was not available to Air Brake's other stockholders.[19] These extensive contacts between Crane and Air Brake are in sharp contrast to the arms-length relationship that Occidental had maintained with old Kern.

Under settled principles, of course, Crane's liability does not depend on proof that it had actual possession of inside information. Section 16(b) imposes liability "without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information." *Kern County Land Co.* v. *Occidental Petroleum Corp., supra*, 411 U.S. at 595. The most direct and compelling evidence of Crane's *access* to inside information, however, is that through its many conversations with

[19] See Schedule of Contacts, pp. 25-30, *infra*.

Air Brake personnel, it in fact *obtained* such information. Crane's chief executive admitted a number of such instances, the most striking of which was that, while Crane was a 10% stockholder and thus a statutory insider, he had received from an Air Brake director advance information about the merger that it was then negotiating with Standard.

Crane's admitted receipt of such information is merely a graphic demonstration that the requisite access to inside information existed; since Crane could and did obtain advance information about this merger—the single most important event in Air Brake's long history—there is no reason why it could not have obtained any and all other corporate secrets as well.[20]

In spite of the undisputed evidence of Crane's possession of inside information, the Court of Appeals held that Crane was entitled to summary judgment. The basis of this holding was an application not of the *Occidental* rule, but of its antithesis. Whereas *Occidental* requires the Court to determine from the circumstances of each "unorthodox" or "borderline" transaction whether the defendant has had access to inside information, the Court of Appeals has here held that any defendant who has made

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[20] Although its decision did not rest on the point, the Court below inaccurately stated that in the District Court Standard did not point to specific instances in which Crane had received inside information. In fact, Standard pointed to several such instances (*e.g.*, Ct. App. A. 63-72), citing them as proof of the ultimate fact at issue—that Crane had *access* to inside information about Air Brake. But regardless of what it did or did not contend in the District Court, Standard as the appellee was entitled to urge on the Court of Appeals any argument in support of the District Court's judgment, including contentions not passed on by the District Court. "A successful party in the District Court may sustain its judgment on any ground that finds support in the record." *Jaffke* v. *Dunham*, 352 U.S. 280, 281 (1957); see *Langnes* v. *Green*, 282 U.S. 531, 535-539 (1931); *Walling* v. *General Industries Co.*, 330 U.S. 545, 547 (1947); Stern & Gressman, *Supreme Court Practice*, 314 (4th ed. 1969).

a contested tender offer is entitled to immunity from § 16(b) regardless of any evidence that inside information was in fact available, obtained and abused.

The Court below, contrary to reason and experience, assumed that the existence of a contest for control creates an adversary relationship that *necessarily* precludes the passage of confidential information. In the present case such an assumption lacks its essential predicate, for Crane had in fact been a 10% stockholder for some ten weeks before it made its tender offer, and during that period, when no such adversary relationship existed, Crane had ample opportunity to obtain inside information, as is demonstrated by the fact that during this period an Air Brake director told Crane of Air Brake's forthcoming merger at $50 per share.[21]

Even after its tender offer had been made and the Air Brake management had determined to oppose it, Crane still had many opportunities to obtain confidential information by reason of its large stockholdings and its continuing contacts with the Air Brake management. While the majority of the Air Brake board ultimately opposed Crane's tender offer, one or more of Air Brake's directors may well have continued to feel—as they had felt previously—that Crane, as Air Brake's largest stockholder, was entitled to be kept abreast of important developments affecting the company. Moreover, some Air Brake employees, well aware of Crane's present large stockholdings and the possibility of a future Crane takeover, may have yielded to the temptation to pass along helpful information in order to curry favor with those who might soon control their company. Such possibilities are of the very sort that prompted Congress to subject all 10% stockholders to § 16(b) whether or not such a stockholder has actual con-

[21] Ct. App. A. 248-249.

trol of the company or even has representation on the board.

Of course, a large stockholder need not control the company in order to have access to confidential information; a single friendly director may provide such access. Crane itself sought to put three representatives on the Air Brake board, and if it had succeeded it would unquestionably have been in a position to obtain confidential information whether or not it could have blocked the merger or exercised control. In such circumstances, liability would scarcely be in doubt. While Crane did not succeed in putting its representatives on the Air Brake board, the record reveals that at least one of the Air Brake directors—John A. Mayer—was friendly to Crane to the extent of supporting Crane's effort to secure representation on the board, opposing the merger with Standard, and providing Crane with advance information about that merger. Liability should not, however, be made to turn on such a will o' the wisp as whether a single director is formally the defendant's representative or is merely, for whatever reason, a supporter of its cause. Least of all should liability in such circumstances be ruled out on a summary judgment motion, as the Court of Appeals has done in this case.

The Court of Appeals brushed aside all evidence of Crane's misuse of inside information by speculating that this information had in fact come to Crane through "casual acquisition" and "personal friendship" rather than through its 10% stock ownership.[22] No such conclusion is supportable on this record and on a summary judgment motion: at the very least, the record raises a triable issue of fact as to whether Crane could have obtained such information if it had not been Air Brake's largest stockholder.

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[22] 20a.

Since Crane repeatedly stressed that it was Air Brake's largest stockholder when talking to that company's personnel, it is inferrable that their willingness to divulge inside information to Crane was attributable to the latter's stockholdings.

But, we submit, no such consideration is admissible. We know of no authority that has suggested that an insider can escape § 16(b) liability by showing—however convincingly—that he could have acquired inside information through means other than his relationship to the issuer. What sources of information would have been available to a particular defendant absent insider status is an imponderable. To permit such a defense would destroy the "mechanical quality" that is the essence of the statutory scheme, *Reliance Elec. Co.* v. *Emerson Elec. Co.*, 404 U.S. 418, 425 (1972), would defeat predictability and deterrence, and would require inordinately difficult fact-finding proceedings.

Nor was the Court below on sound ground in relying on Crane's lack of control over the merger. The statute does not speak of control, but of status; certain insiders are presumed, under the statutory scheme, to have access to inside information, yet many or most of such persons lack control. Generally, no single officer or director controls a corporation; that power lies in the majority of the board. Similarly, a 10% stockholder may well lack control. Any officer, any director and any 10% stockholder may in fact be a dissenter from a given corporate decision, such as a decision to merge. But because of his presumed access to confidential information, such an insider is made liable by statute for any short-swing profits he realizes in the company's stock. To impute knowledge only when there is control, as the Court below did in this case, is to introduce a foreign element into the statutory scheme.

Underlying this ruling is the Court's novel and, we submit, unwarranted assertion that tender offers are "*sui generis*" and are favored by some sort of "public policy" because they sometimes benefit the company and its stockholders. There is not the slightest warrant in the statute or its legislative history for placing tender offerors in the unique position of having immunity from the liabilities to which all other insiders are subject. Many corporate insiders confer benefits on the shareholders at large. Officials who negotiate favorable contracts, develop pioneering inventions or discover valuable mineral deposits are surely conferring substantial benefits on their corporation, its shareholders and often the public at large, yet it has never been suggested that such officials are free to enrich themselves by engaging in short-swing transactions in their company's stock. In the present case, in condoning Crane's insider trading on the ground that the transactions in question may have conferred a benefit on the company and its stockholders, the Court of Appeals has made an unsound departure from settled law and policy.

Moreover, there is no basis for the Court's assumption that the "small stockholder" would realize significant benefits from a competition in which two firms bid for control of a third "with all the cards on the table" (18a) when, as here, the party making the tender offer is a large stockholder who has plainly had access to inside information not available to all other stockholders. There is no sound reason, in law or policy, for the courts to facilitate the making of tender offers on any such unfair basis. A tender offeror can often bring itself within the *Occidental* rule by maintaining a strictly arms-length relationship with the target company, as did Occidental itself. It need not, as Crane did, establish a relationship with the issuer's management whereby it can have ready access to inside information.

When, like Crane, it chooses to establish such a relationship and to receive inside information, the policy underlying § 16(b) requires that liability should be imposed.

In any event, nothing in the present case suggests that Crane conferred any benefit on the Air Brake stockholders. Unlike Occidental, whose tender offer preceded the announcement of the merger between old Kern and Tenneco, Crane made no tender offer for Air Brake until a month after Air Brake and Standard had announced their merger, and Crane's offer, from the stockholders' standpoint, was substantially inferior to the merger, as is apparent from the relative market prices of Crane's debentures and the merged company's preference stock. Prior to making its tender offer, Crane purchased Air Brake stock on the stock market without any disclosure regarding either Crane itself or its plans for Air Brake. Crane admittedly knew of the impending merger some six weeks before any "small stockholder" did, and spent most of that period in an intensive but unpublicized effort to purchase on the stock exchange as many Air Brake shares as it could before the merger was announced. During those weeks countless small stockholders who lacked Crane's inside knowledge of the forthcoming merger at $50 per share sold their shares for far less.

In decreeing a "public policy" in favor of tender offers and permitting that policy to override the expressed statutory policy of preventing the misuse of inside information by insiders, the Court of Appeals has usurped the function of both Congress and the SEC. For a judge-made "public policy" to override a specific statutory enactment would be inappropriate in any event, but it is singularly inapposite in the case of § 16(b), where Congress has chosen to delegate to the SEC the authority to make legislative exceptions to the otherwise "flat rule" laid down in the statute itself. The SEC, which of course has special re-

sponsibilities and expertise in the field of securities regulation, has frequently exercised this authority by promulgating rules exempting certain types of transactions from § 16(b). Notably, however, the SEC has refused to exempt transactions such as that involved in this case. Indeed, it specifically refused to do so at the behest of Occidental Petroleum, 411 U.S. at 588, perhaps believing that a case-by-case determination would best serve the statutory purposes. But the Court below, in rejecting the case-by-case approach of *Occidental* in favor of a flat rule exempting all tender offerors from insider liability, has undercut the SEC's position and usurped the authority that Congress has conferred on it.

II.

Acknowledging that the question was one of first impression, the Court of Appeals further held that Crane's premerger purchases of Air Brake stock for cash and in exchange for its own debentures cannot be matched, for § 16(b) purposes, against its postmerger cash sale of the shares of the merged entity, on the stated ground that § 16(b) is applicable only to purchases and sales of the "same" issuer and that a corporation and its successor-by-merger are "different" issuers.

This is an unnecessarily literalistic reading of the statute. The premerger Air Brake and the postmerger Standard were successive owners of a single continuing enterprise. The happenstance that the merged entity continued business under Standard's name rather than Air Brake's and that Standard was treated as the survivor for certain internal purposes does not alter the fact that this was a case of direct corporate succession as a matter of law. If

Standard had merged into Air Brake, rather than Air Brake into Standard, no one would seriously maintain that the merged company was not the "same" issuer as Air Brake, or that the merged company's common stock was not the "same" stock as the Air Brake common before the merger. The Court of Appeals has permitted certain technical, housekeeping details of this merger transaction to govern the result for § 16(b) purposes. These details have nothing whatever to do with the purpose of § 16(b), which is to prevent the unfair use of confidential information by insiders. To apply this statute on such an irrelevant basis is to negate its purpose.

The Court's ruling is also inconsistent with long-established regulatory concepts relating to securities issued in mergers, consolidations and similar transactions. The rules of the Securities and Exchange Commission promulgated under the Exchange Act recognize that a security issued by a merged company to the holders of one of the merging companies' securities is a "successor security" issued in "substitution" for the security of the merging company. See, *e.g.*, Rules 12a-5, 12d2-2(a) and 12g-3(a). In the present case the convertible preference stock issued by the merged company to Crane and the other former Air Brake stockholders was a "successor security" to, and was issued in "substitution" for, the Air Brake common under Rule 12d2-2(a), and this "successor security" was traded for several weeks after the merger under the temporary exemption provided by Rule 12a-5 for "substitute" securities, the registration of the Air Brake common remaining in effect as required by Rule 12d2-2(a) until the registration of the "substitute" securities had been completed.[23]

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[23] Similarly, in the case of over-the-counter securities, under the Commission's Rule 12g-3(a) in the case of a "succession by merger" the securities issued by the merged company to holders of registered shares of one of the merging companies shall themselves be deemed to be registered except under stated circumstances.

The Commission's rules thus recognize the continuity that takes place when two or more companies merge, consolidate or otherwise combine. The Court of Appeals, in conceiving of a merged company as being a "different" issuer from that of its predecessors, has made a sharp departure from these established principles.

The "policy" considerations said to justify this result do not survive scrutiny. The Court said that "a sensible policy" should permit divestiture by anyone in Crane's position for "it did not intend [the merged] company to be its investment vehicle" and "to make it hold on to the stock which it received in [the] exchange would be to compel it to subject itself to the vagaries of the market. . . ." (35a-36a). Since Crane in fact learned of Air Brake's impending merger at virtually the same time it became a 10% stockholder, it was at least aware of the possibility that it might soon own shares in the merged company.

In any event, § 16(b) specifically provides that liability shall be imposed "irrespective of any intention on the part of [the insider] . . . in entering into such transaction of holding the security purchased . . . for a period exceeding six months." Liability will result even when the sale has been compelled by circumstances beyond the owner's control. *Western Auto Supply Co.* v. *Gamble-Skogmo, Inc.*, 348 F.2d 736 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966); *Alloys Unlimited, Inc.* v. *Gilbert*, 319 F. Supp. 617 (S.D.N.Y. 1970). And as to subjecting Crane

to "the vagaries of the market," that is no more than the consequence that Congress has imposed on every insider, who must retain his investment for six months without regard to personal or economic hardship arising from changing circumstances, anticipated or unforeseen.

At bottom, the Court of Appeals' holding appears to rest on the same "policy" footing on which it sought to justify its conclusion that the merger itself was not a "purchase" or a "sale"—the declaration that tender offers are "*sui generis*" and that those who make them are entitled to escape the rules applicable to all other insiders. For reasons stated above, we submit that the asserted policy is unsound. But even if it were a sufficient justification for holding that liability did not attach by virtue of the merger itself, it would not justify the further holding that liability does not arise from a cash sale either. As Judge Friendly said in his *Occidental* opinion, in the case of "a garden-variety purchase and sale or sale and purchase within six months . . . it would be no defense that a person [within the terms of the statute] was operating, by sheer intuition, from Antarctica or even from outer space. . . ." *Abrams* v. *Occidental Petroleum Corp.*, 450 F.2d 157, 162 (2d Cir. 1971), *affirmed*, 411 U.S. 582 (1973). In short, under the facts presented in this case there is no room for extraneous considerations, of a policy nature or otherwise; liability is imposed automatically in order to preserve this statute's "mechanical quality." *Reliance Elec. Co.* v. *Emerson Elec. Co.*, 404 U.S. 418, 425 (1972).

Conclusion

For the foregoing reasons certiorari should be granted and the judgment below should be reversed.

Respectfully submitted,

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March 19, 1975

SCHEDULE OF CRANE'S CONTACTS WITH AIR BRAKE AND STANDARD

Date	Crane Representatives	Air Brake or Standard Representatives	Meeting or Telephone Conversation	Record Citation
5/25/67	Crane Chairman Evans Crane Director and Mellon National Bank Director Veatch	Air Brake Director Mayer	Meeting	2461 R. 87(3) at p. 36; 2461 R. 87(8) at p. 170; Ct. App. A. 142, 143, 146, 149, 193, 195, 221-222, 226-227; 1560 R. 54 at p. 183; 1560 R. 55 at p. 340
6/67	Crane Chairman Evans	Air Brake Director Mayer	Telephone	2461 R. 87(8) at pp. 172, 178; Ct. App. A. 195, 229
6/ 5/67	Crane Chairman Evans	Air Brake Chairman McCord	Telephone	2461 R. 87(1) at p. 41
7/13/67	Crane Chairman Evans	Air Brake Director Mayer	Telephone	2461 R. 87(8) at p. 178
8/29/67	Crane Chairman Evans	Air Brake Chairman McCord Air Brake Officer Wood Air Brake Vice Pres. Lenon	Meeting	Ct. App. A. 148-150, 158, 159-160, 229, 232-233; 1560 R. 55 at p. 267; 2461 R. 87(3) at pp. 48-49; 2461 R. 87(8) at p. 383
8/30/67	Crane Director Veatch	Air Brake Director Mayer	Telephone	Ct. App. A. 195
9/13/67	Crane Chairman Evans	Air Brake Director Mayer	Meeting	Ct. App. A. 160-161
9/ /67	Crane Chairman Evans	Air Brake Director Worthington	Meeting	Ct. App. A. 152-153, 234
9/21/67	Crane Chairman Evans Crane Director Veatch	Air Brake Director Mayer	Meeting	Ct. App. A. 195, 222, 235, 236; 1560 R. 55 at pp. 340-341
9/26/67	Crane Chairman Evans	Air Brake Director Shoemaker	Meeting	Ct. App. A. 234

SCHEDULE OF CRANE'S CONTACTS WITH AIR BRAKE AND STANDARD

Date	Crane Representatives	Air Brake or Standard Representatives	Meeting or Telephone Conversation	Record Citation
10/16/67	Crane Chairman Evans	Air Brake Chairman McCord	Telephone	Ct. App. A. 162
10/18/67	Crane Director Veatch	Air Brake Director Mayer		Ct. App. A. 195
10/20/67	Crane Chairman Evans	Air Brake Chairman McCord Air Brake Officer Wood	Meeting	Ct. App. A. 162 Ct. App. A. 237
11/14/67	Crane Chairman Evans Crane Director Veatch	Air Brake Director Mayer	Meeting	2461 R. 87(5) at p. 133; Ct. App. A. 155, 195, 238-239; 1560 R. 55 at pp. 346-347
11/ /67	Crane Chairman Evans	Air Brake Director Shoemaker	Meeting	2461 R. 87(4) at p. 117; Ct. App. A. 150-151
11/ /67 (around Thanksgiving)	Crane Director Stout	U.S. Steel Chairman (ret.) Love [a friend of Air Brake Chairman McCord]	Meeting	Ct. App. A. 164-165
11/ /67	Crane Director Williams [former Air Brake employee]	Air Brake Director Worthington	Telephone	2461 R. 87(5) at p. 134
Latter part of November	Crane Director Stout	U.S. Steel Chairman (ret.) Love [a friend of Air Brake Chairman McCord] Air Brake Chairman McCord Air Brake Director Worthington Air Brake Director Shoemaker	Meeting	Ct. App. A. 180-181; 1560 R. 55 at p. 264
11/27/67	Crane Director Veatch	Air Brake Director Mayer	Meeting	Ct. App. A. 195

SCHEDULE OF CRANE'S CONTACTS WITH AIR BRAKE AND STANDARD

Date	Crane Representatives	Air Brake or Standard Representatives	Meeting or Telephone Conversation	Record Citation
12/8 thru 12/10/67 or 12/7 thru 12/14/67	Crane Director Stout	U.S. Steel Chairman (ret.) Love [a friend of Air Brake chairman McCord] Air Brake Director Shoemaker Air Brake Director Worthington	Meeting	2461 R. 87(5) at p. 74; 2461 R. 87(8) at pp. 340-341; Ct. App. A. 166-167, 177-179, 243
12/10/67	Crane Chairman Evans Crane Director Veatch	Air Brake Director Mayer	Meeting	2461 R. 87(5) at p. 74; 2461 R. 87(8) at p. 142
12/11/67 or 12/12/67	Crane Chairman Evans Crane Director Veatch	Air Brake Director Mayer	Meeting	2461 R. 87(2) at p. 37; R. 87(8) at pp. 142, 186-188; Ct. App. A. 196, 240-243; 1560 R. 55 at pp. 347-349
Sometime between 12/8 and 12/12/67	Crane Chairman Evans	Air Brake Chairman McCord	Telephone	Ct. App. A. 167
12/13/67	Crane Chairman Evans Crane Director Veatch	Air Brake Chairman McCord Air Brake Officer Wood	Meeting	2461 R. 87(5) at pp. 75, 141; 2461 R. 87(8) at pp. 163, 381-384; Ct. App. A. 242, 243, 245-246, 1560 R. 54 at pp. 207-208, 211-212; 1560 R. 55 at pp. 268-269; 349-350; 2461 R. 87(4) at pp. 92-93

SCHEDULE OF CRANE'S CONTACTS WITH AIR BRAKE AND STANDARD

Date	Crane Representatives	Air Brake or Standard Representatives	Meeting or Telephone Conversation	Record Citation
12/ /67 (after 12/13/67)	Crane Chairman Evans	Air Brake Director Hanley	Meeting	Ct. App. A. 156-157
12/67	Crane Chairman Evans	Mr. Beighley (a friend of Air Brake Chairman McCord)	Meeting	2461 R. 87(5) at p. 76; Ct. App. A. 156
12/67	Crane Chairman Evans	Air Brake Director Shoemaker	Meeting	Ct. App. A. 151-152, 156
12/67	Crane Chairman Evans	Air Brake Director Worthington	Telephone	Ct. App. A. 153
12/67	Crane Chairman Evans	Air Brake Director Worthington	Meeting	Ct. App. A. 154
12/67 or 1/68	Crane Chairman Evans	Air Brake President Walkley	Meeting	Ct. App. A. 158
1/15/68	Crane Chairman Evans	Air Brake Director Mayer	Meeting	2461 R. 87(2) at pp. 42-45; Ct. App. A. 196
1/ /68	Crane Chairman Evans	U.S. Steel Chairman (ret.) Love [a friend of Air Brake Chairman McCord]	Meeting	Ct. App. A. 209, 252
1/68 (last wk. in January)	Long of King Proxies Listing [Crane Agent]	Representatives of First Boston [Air Brake Agent]	Meeting	Ct. App. A. 216
1/68 (last two weeks)	Crane Chairman Evans	Air Brake Employee	Meeting	Ct. App. A. 144-145
2/14/68	Crane Director Veatch	Air Brake Director Mayer	Meeting	2461 R. 87(2) at pp. 42, 45; Ct. App. A. 196
2/16/68	Crane Chairman Evans	Air Brake Director Mayer	Telephone	Ct. App. A. 196

SCHEDULE OF CRANE'S CONTACTS WITH AIR BRAKE AND STANDARD

Date	Crane Representatives	Air Brake or Standard Representatives	Meeting or Telephone Conversation	Record Citation
2/23/68	Crane Chairman Evans	Air Brake Director Mayer	Meeting	Ct. App. A. 196, 207-208, 247, 249, 252
2/23/68	Crane Chairman Evans	Air Brake Director Mayer Air Brake Chairman McCord	Telephone	Ct. App. A. 249
2/23/68	Crane Chairman Evans	Air Brake Director Mayer Air Brake Director Hanley	Telephone	2461 R. 87(4) at pp. 17, 141-142; Ct. App. A. 249-250
2/23/68	Crane Chairman Evans	Air Brake Director Shoemaker	Meeting	2461 R. 87(4) at pp. 13, 142; Ct. App. A. 247, 250-251
3/ 4/68	Crane President Fabiani	American Standard President Eberle	Telephone	2461 R. 93 at p. 20; 2461 R. 91 at p. 96; 1560 R. 54 at p. 228
3/ 4/68	Crane President Fabiani Crane Chairman Evans	American Standard President Eberle American Standard Officer Ward	Meeting	2461 R. 91 at pp. 96-97; 2461 R. 93 at pp. 4-7; 2461 R. 87(4) at pp. 109-110; 1560 R. 54 at pp. 228, 251, 257-258
3/68 ["shortly after" 3/4/68]	Crane President Fabiani Crane Chairman Evans	American Standard President Eberle American Standard Officer Ward	Meeting	2461 R. 93 at pp. 7, 22
3/22/68	Crane Director Veatch	Air Brake Director Mayer	Telephone	1560 R. 54 at p. 232

SCHEDULE OF CRANE'S CONTACTS WITH AIR BRAKE AND STANDARD

Date	Crane Representatives	Air Brake or Standard Representatives	Meeting or Telephone Conversation	Record Citation
4/ 4/68	Crane Chairman Evans Crane President Fabiani Crane Counsel Kirkpatrick	Entire Air Brake Board (except for McGee & Hodge)	Meeting	2461 R. 93 at pp. 14-15; 2461 R. 95 at pp. 23-24; Ct. App. A. 196, 254-258, 262-263
4/ 4/68	Crane Counsel (Internal) Ipe	Air Brake Legal Department	Meeting	2461 R. 93 at p. 66
4/ 5/68	Crane Director Veatch	Air Brake Director Mayer	Meeting	2461 R. 87(4) at p. 78; Ct. App. A. 196
5/ /68	Crane Chairman Evans	Air Brake Director Mayer	Meeting	Ct. App. A. 259

APPENDIX A

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 97—September Term, 1974.

(Argued October 23, 1974 Decided December 20, 1974.)

Docket No. 74-1233

AMERICAN STANDARD, INC.,

Plaintiff-Appellant,

—against—

CRANE CO.,

Defendant-Appellant and Third-Party Plaintiff,

—against—

EDWARD J. HANLEY, et al.,

Third-Party Defendants.

Before:

MOORE, OAKES, and GURFEIN,

Circuit Judges.

The successor by merger of a target company brought an action under § 16(b) of the Securities Exchange Act to recover profits from a defeated tender offeror which had been a competitor for control of the target company. The United States District Court for the Southern District of New York (Morris E. Lasker, *District Judge*) granted partial summary judgment to the plaintiff on the issue of

liability. *Held* that profits allegedly realized by the competitor by way of an exchange of stock pursuant to the merger within six months of its original purchase of stock of the target company were not recoverable because of the absence of a possibility for speculative abuse. *Further held* that the purchase of stock in the acquired company and the sale of stock received pursuant to the merger within six months could not be matched for § 16(b) purposes, since the different securities were not those of the same issuer.

Reversed and remanded with instructions to enter judgment dismissing the complaint.

ABRAHAM L. POMERANTZ, New York, N.Y. (Pomerantz Levy Haudek & Block, William E. Haudek, New York, N.Y., and Lord, Day & Lord, John W. Castles 3rd and Michael J. Murphy, New York, N.Y., of Counsel), *for Defendant-Appellant* CRANE CO.

DAVID W. PECK, New York, N.Y. (Sullivan & Cromwell, Edward W. Keane, Robert M. Osgood and Marcia B. Paul, New York, N.Y., of Counsel), *for Plaintiff-Appellee* AMERICAN STANDARD, INC.

HERBERT L. SCHARF, New York, N.Y. (Bobroff, Olonoff & Scharf; Alfred Olonoff, New York, N.Y., of Counsel), *for Plaintiff-Appellee* KRITZLER.

WOLF, POPPER, ROSS, WOLF & JONES, New York, N.Y. (Donald N. Ruby and Robert M. Kornreich, New York, N.Y., of Counsel), *for Plaintiff-Appellee* ABRAMS.

Appendix A—Opinion of the Court of Appeals

GURFEIN, *Circuit Judge:*

This is the third in a trilogy of appeals to come before this court in the continuing litigation between American Standard, Inc. ("Standard") and Crane Co. ("Crane") arising out of the contest for control of Westinghouse Air Brake Company ("Air Brake") which Standard has won, succeeding in effecting a merger of Air Brake into Standard. In *Crane Company* v. *Westinghouse Air Brake Company et al.*, 419 F.2d 787 (2 Cir. 1969), *cert. denied*, 400 U.S. 822 (1970) (Crane I) this court held, *inter alia*, that Standard had violated both Section 9(a)(2) and Rule 10b-5 of the Securities Exchange Act by a market manipulation which artificially raised the price of Air Brake stock on the last day of Crane's tender offer for the stock, and remanded that cause for appropriate remedies.[1] In *Crane Co.* v. *American Standard, Inc.*, 490 F.2d 332 (2 Cir. 1973), we held that the fraud action mentioned above should be tried to the court without a jury (Crane II).

The present appeal concerns a separate action brought against Crane for alleged violation of Section 16(b) of the Securities Exchange Act ("the Act") by Standard, as well as by two stockholders of Air Brake, Kritzler and Abrams, and a stockholder of Standard, to recover alleged short-swing profits of Crane.[2] The short-swing profits are alleged to have arisen through trading by Crane in equity securities

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1 The court held in favor of Standard on all other points including an attack on its proxy statement.

2 The actions were consolidated in January 1969, 490 F.2d at 338. The claim of Kritzler and Abrams is that Crane is liable to the former Air Brake stockholders rather than to Standard. Under the order of consolidation this claim is in abeyance pending determination of whether Crane is liable.

of Air Brake up to the date of Air Brake's merger with Standard and of the merged company thereafter.[3]

The District Court, Lasker, *J.*, denied Crane's motion for summary judgment and granted partial summary judgment to Standard on the issue of Crane's liability. 346 F. Supp. 1153. Crane appeals from this decision by permission of this Court pursuant to 28 U.S.C. § 1292(b) and F.R.A.P. 5.

Though the background of this controversy has been set forth in previous opinions, it is necessary to repeat it to

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3 Section 16(a) reads:

"Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 781 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 781(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

Section 16(b) reads:

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a

some extent. Crane first proposed a merger of Crane and Air Brake to the Air Brake management on May 15, 1967. 419 F.2d at 790. In June 1967 Crane began to acquire large quantities of Air Brake shares in the open market for the purpose of acquiring control. It continued its purchases into 1968. On December 7, 1967 Air Brake changed its by-laws to raise the minimum cumulative vote needed to obtain representation on the board from 9.1 to 25 per cent. 419 F.2d at 790. On December 13, 1967 Air Brake declined the proposal for merger.

Although Crane then briefly discontinued its open market purchases of Air Brake common stock, it resumed them in January becoming a more than 10% owner on January 26, 1968, thereby achieving the status of a "beneficial owner" for § 16(b) purposes.

Air Brake responded by arranging a "defensive" merger with Standard. On February 20, 1968 A. King McCord, President of Air Brake, met with several of his directors to consider a proposal which had been submitted by Blyth & Company the day before, to merge Air Brake into Standard by exchanging Air Brake common stock for a Standard security to be valued at about $50 per share. Air Brake common was then quoted at about $36 per share. 419 F.2d at 791.

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period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

On the very day McCord was meeting on the Standard merger proposal, Crane, now a 10% stockholder, filed a 14B statement with the Securities and Exchange Commission declaring its intention to solicit proxies for the Air Brake Board election.

On March 1, 1968 McCord reached an agreement on the terms of the merger with representatives of Standard, and on March 4 the Air Brake Board voted its approval. On March 5 Air Brake informed its shareholders of the terms of the agreement and of the Board's approval. Air Brake stock rose to $44. (ibid.)

In the proposed merger, every two shares of the outstanding Air Brake stock were to be converted into one share of a new class of Standard $4.75 cumulative convertible preference stock. Each Standard preference share was to be convertible into 2⅔ shares of Standard common. Upon consummation of the merger Air Brake's existence was to end.

In the face of this previously announced merger agreement by Air Brake and Standard managements, Crane on April 6, 1968 publicly announced a registered tender offer to exchange $50 face value of its debentures for each Air Brake share.[4] The offer was to expire April 19 unless renewed. At this time, as has been noted, Crane was already a 10% holder of Air Brake common. Air Brake reacted quickly. On April 8, 1968, Air Brake called a meeting of its stockholders for May 16 to vote on the proposed merger with Standard. The Crane offer was set to expire unless renewed, as noted, about a month before that stockholders' meeting.

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4 In exchange for each Air Brake share, Crane offered to issue $25 principal amount of its 5% subordinated convertible debentures and $25 principal amount of its 7% subordinated debentures, both due in 1993. The 5% debentures were convertible into Crane common stock at $50 per share (i.e., 20 shares for each $1,000 debenture).

Appendix A—Opinion of the Court of Appeals

On the last day of Crane's tender offer, April 19, as this Court held, 419 F.2d 787, Standard fraudulently manipulated the market through a series of concealed wash sales with the intended result that the market price of Air Brake rose to $50. Crane's initial offer failed. Crane extended its offer three times to April 29, May 14 and May 24, 1968, but failed to gain a majority.[5] On April 17, 1968 Crane brought a federal court action against Air Brake charging a violation of the proxy rules. On May 6, 1968, Crane brought suit against Standard and its underwriter, Blyth and Company, under the fraud provisions of the Act and Rule 10b-5 to enjoin the merger. The District Court ultimately dismissed the action.[6]

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5 Judge Smith described Standard's April 19th activities and their result as follows:

> "The critical day in the take-over battle was April 19, the day Crane's tender offer for Air Brake stock was to expire. The holders of Air Brake stock could be expected to delay until the last moment in order to make a decision based on the latest market information, i.e., to compare the value of the tender offer, here not more than $50, with the market price on the day the offer was to expire. In fact, 85 percent of the shares tendered to Crane by the 19th were offered on that day. [citation] On April 19, Air Brake opened at 45¼ on the New York Stock Exchange, giving Crane's tender offer a good prospect of success. The surest way to defeat the Crane offer was to run the price up to $50. The tape did quickly reach $50 on April 19, and Crane's tender offer failed. Crane's claim that this was the result of extraordinary transactions by Standard is supported by the record.
>
> ". . . The net result of this buying was to present to the public, whose primary source of information is the tape, that there was a great demand for Air Brake at an increased value. It is reasonable to conclude that many Air Brake stockholders who might otherwise have chosen to tender to Crane chose not to do so because their own holdings in Air Brake looked better as the price went up.
>
> "Standard had 'painted the tape' in Air Brake stock. . . .
>
> "Standard's extraordinary buying here, coupled with its large secret sales off the market, inevitably distorted the market picture and deceived public investors, particularly the Air Brake shareholders." 419 F.2d at 792-93.

6 This court reversed the dismissal of the fraud action in Crane I.

Appendix A—Opinion of the Court of Appeals

On or about May 16, 1968, the Air Brake stockholders voted to approve the merger with Standard. On June 7 the merger became effective and the Standard convertible preference stock became available for exchange for Air Brake common. By this time, Crane owned 32% of Air Brake common. Between June 7 and June 13, Crane actually exchanged its then holdings of 1,408,623 Air Brake shares for 740,311 of Standard. Standard was Crane's largest competitor in the plumbing industry. 419 F.2d at 791. Crane also became by virtue of the merger, the largest, or one of the largest stockholders of Standard.

On June 13, Crane sold 730,311 shares of Standard convertible preference stock on the New York Stock Exchange for $76,134,921.75 at a profit estimated at over $10,000,000. Four days thereafter, on June 17, 1968, Standard commenced its present 16(b) action. Shortly after that Crane sold 9,000 of its remaining 10,000 shares.

Crane had acquired its Air Brake stock as follows:

	Air Brake Shares Purchased by Crane
6/15/67—1/26/68 (market)	469,200
1/31/68—4/2/68 (market)	202,900
4/19/68 (tender offer)	316,662
4/29/68 (first extension of tender offer)	212,883
5/14/68 (second extension of tender offer)	98,594
5/24/68 (third extension of tender offer)	180,384
	1,480,623

Standard contends in this court that Crane, through its Chairman, Thomas Mellon Evans, had the possibility of acquiring inside information and that it actually did ac-

quire such information. Crane denies the fact but urges us not to consider this argument, in any event, because the facts now urged in support had not been called to the attention of the District Court on the motion for summary judgment.[7] These alleged facts deal largely with the activities of Evans, president of Air Brake.

The facts relevant to Evans' activities as they appear in the affidavit of George C. Kern, Jr., annexed to the motion papers on the summary judgment motion, were given as follows:

In June 1967 the Crane Board authorized Evans to buy Air Brake stock as he thought it advisable. In the latter part of 1967, Crane revealed its substantial ownership to the Air Brake management and proposed that Air Brake be merged into Crane. On December 13, 1967 Evans was told by Air Brake that it was not interested in any kind of merger with Crane. The Chairman of Crane "came to the conclusion that there was no way we could deal with them or that they would deal with us." By January, 1968

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7 A motion for summary judgment was made by Crane on May 27, 1970 on the ground that "the findings of the Court of Appeals [in Crane I] are dispositive of this action and entitle Crane to summary judgment dismissing the consolidated complaint. Standard cross-moved for summary judgment on June 23, 1970 on the issue of liability alone. It based its motion on an "annexed affidavit of George C. Kern, Jr., the record in the two civil actions (heretofore consolidated) entitled 'Crane Co., plaintiff, against Westinghouse Air Brake Company et al., defendants' (S.D.N.Y. No. 68 Civ. 1560) and 'Crane Co., plaintiff, against American Standard, Inc., et al., defendants' (S.D.N.Y. No. 68 Civ. 1845), 'Plaintiff's Statement of Material Facts Pursuant to this Court's General Rule 9(g), defendants' answers to plaintiff's interrogatories dated July 2, 1968 and all pleadings and proceedings heretofore had herein.'"

Kern's affidavit also mentions "a third action brought in the Court of Common Pleas of Allegheny County, Pennsylvania, entitled 'Crane Co., plaintiff, against Westinghouse Air Brake Co., defendant' (No. 249 April Term, 1968)" and purports to incorporate by reference the trial transcript, although the notice of motion itself makes no mention of the Pittsburgh action.

Crane had "dropped" its plans to merge with Air Brake. It bought no stock between January 5 and January 24. In the early part of 1968 Crane had heard "from various sources" that Air Brake was negotiating with other companies. On March 4, 1968, the President of American Standard, W.D. Eberle, met with Evans and told him that Air Brake and Standard had agreed to merge and that a press release to that effect would be issued later in the day.

Judge Lasker's attention was not called to any specific incident in which Evans purportedly received inside information.

Standard now urges us to consider additional facts not directly called to Judge Lasker's attention but which it argues could have been found by combing the record. It notes that, between the acquisition of beneficial owner status on January 26, 1968 and the public announcement of the Air Brake-Standard merger on March 4, 1968, Evans met with Air Brake Director Mayer and separately with Director Shoemaker on February 23rd, and had a telephone conversation with Mayer on February 16 and with Chairman McCord and Director Hanley on February 23. Mayer, who was also Chairman of the Mellon Bank, which was one of Crane's banks, argued against the Standard merger and discussed favorably with Evans putting some Crane representatives on the Air Brake Board. In pursuit of that objective, Evans telephoned Mayer on February 23rd to ask if he would not arrange a meeting with the directors of Air Brake to consider his request for three directors on the Air Brake Board. During the conversation Mayer told Evans that he thought Air Brake was going to get an offer of $50 in cash. He did not mention the name of the offeror. Nor did he mention an acquisition of Air Brake for a certain number of convertible preference shares nor any ratio of

exchange. Evans replied that they had not bought the stock for "stock speculation," that he would like to hear more about it "but I don't think that is what we want." [8]

Before becoming a 10% holder, Evans had heard through a proxy solicitor, who was under retainer to Crane, that Air Brake management intended to peddle the company, apparently to thwart Crane's attempt to take over. Having become aware of this classic defensive maneuver to defeat an unwanted suitor Crane apparently decided to become a 10% holder, to continue buying beyond that point and not to give up the fight.

After the February 23rd conversation with Mayer the schedule of stock purchases indicates that Crane did nothing about the "information" either immediately or on a large scale. Crane bought no shares whatever until March 1 when it picked up 1200 shares to add to the 500,000 shares it already owned. By March 4 when the merger was publicly announced, Crane had acquired an additional 1600 shares of Air Brake.

As we have seen, on March 4, the Air Brake people informed Evans that they would announce a merger with

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8. On March 1, 1968 Evans sent a telegram to Air Brake's Chairman stating:

> "We are advised that you have been negotiating a merger or sale of Westinghouse Air Brake Company. . . . Request that you and your directors make no commitment with respect to merger proposals involving other companies without first giving Crane Co. your Company's largest stockholder the opportunity to make a counter proposal that would be more favorable to all [Air Brake] stockholders. . . ."

On April 4, 1968 Evans and associates met with the Air Brake Board, analyzed the Standard balance sheet as overstated, and still pressed for approval of Crane's plan instead. When the presentation of Crane was turned down, Crane announced its tender offer two days later, on April 6.

The other subject of the meeting was the request of Crane for a stockholders' list which was refused absolutely. Crane had to sue to get the list. *Crane Co.* v. *Westinghouse Air Brake Co.*, 56 Misc. 2d 538, 228 N.Y.S. 2d 984 (Sup. Ct. N.Y. Co., 1968).

Standard later that day, which they did. After the terms of the Standard merger had been announced and had become public property, Crane engaged in large purchases of Air Brake, culminating in its own tender offer of April 6 described above.[9] There is no clear evidence tendered to us of the likelihood that Crane had received any other information that could be classified as "inside information" after becoming a 10% holder which was not also public knowledge.[10]

The Claim

The claim that Crane is liable to Standard for its profit embraces the following alternative theories of "purchase" and "sale": Claim (1) The purchase of Air Brake shares on January 26, 1968 which put Crane in the position of a 10% holder was the initial "purchase", and the *exchange* of that stock pursuant to the merger terms for Standard convertible preference stock was the "sale"; Claim (2) The "purchase" was the exchange of Air Brake stock for Standard convertible preference shares under the merger terms, and the "sale" was the sale for cash of those shares within six months; Claim (3) The purchase of the *Air Brake* stock as in Claim (1) was the "purchase", and the matching "sale" was the sale of the *Standard* convertible preference stock received on the merger.

Proceedings in the District Court

The District Court rendered its decision granting summary judgment to Standard on liability under § 16(b).

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9 After the merger plan was announced it was not "inside information". See *Kern County Land Co.* v. *Occidental Corp.*, 404 U.S. 582, 597-98 (1973).

10 In any event, no information was given to Crane by virtue of its ten per cent ownership.

346 F. Supp. 1153 (Oct. 12, 1971), a day before this Court decided *Abrams* v. *Occidental Petroleum Corp.*, 450 F.2d 157 (2 Cir., Oct. 13, 1971). The District Court had noted that "*Abrams* had many elements in common with the instant action" and it had followed the reasoning of the District Court in that case, 323 F. Supp. 570, the reversal of which was announced by the Court on the following day.[11]

Following the reversal of *Occidental*, Judge Lasker withdrew his opinion to consider its effect. After consideration, the District Court adhered to its earlier decision in a supplemental opinion. 346 F. Supp. 1165. This appeal is from that decision.

In its first decision the District Court had held that Crane was liable under 16(b) for its profits on the basis of what we have called Claim (1); that is, that the *exchange* of Air Brake common stock for Standard convertible preference stock was a "sale" for 16(b) purposes. The District Court reasoned that a company seeking to acquire a target company must know that there was a likelihood of a defensive merger which, upon its consummation, would give it a handsome profit even if it failed to succeed in the takeover. This was thought to create a "heads I win, tails you lose" situation which required the imposition of liability under 16(b).

In this first decision the District Court held accordingly "that the conversion of Crane's Air Brake stock into Standard stock constituted a sale of Air Brake to be matched against its cash purchases of that stock within a period of six months prior to the date of conversion." 346 F. Supp. at 1161. Alternatively, the District Court, treating the Standard stock and the Air Brake stock as the same stock, held that the "sale" for 16(b) purposes was the cash sale by Crane of the Standard convertible preference stock

11 The decision of this court was later *aff'd sub nom. Kern County Land Co.* v. *Occidental Petroleum Corp.*, *supra*.

within six months of its original acquisition of the Air Brake common stock. 346 F. Supp. at 1163.

When the decision of this Court in the *Occidental* case was called to the attention of the District Court, it recognized that on the question of whether Crane's position offered the opportunity for speculative abuse, this court's *ratio decidendi* in *Occidental* might well raise serious doubts whether Standard's motion for summary judgment could be granted on the basis that the *exchange of Air Brake stock for Standard stock in the merger* was a "sale" that triggered 16(b) liability. Instead, the Judge wrote a supplementary opinion in which he now relied upon the alternative theory of liability, what we have called Claim (3). The District Court held that, putting the exchange of stock on the merger to one side because of the *Occidental* decision, there was, nevertheless, a purchase of Air Brake stock and a sale for cash of the Standard stock received on the merger within six months which must be matched for § 16(b) purposes. 346 F. Supp. at 1167-68. He properly noted that in *Occidental* the actual sale for cash (through the exercise of an option) took place more than six months from the effective date of purchase for § 16(b) purposes, whereas here the sale for cash was within the six months period.

The appellee, thus, does not come to this court with the benefit of a holding by the District Court in the face of the *Occidental* reversal that it was the *exchange of stock in the merger* that was the "sale" for § 16(b) purposes.[12]

Nor does it appear from the tenor of Judge Lasker's supplementary opinion that Standard pressed upon him seriously the contention, now pressed upon us, that *Oc-*

12 Not discussed, however, was the question whether the exchange of Air Brake stock for Standard stock on the merger could be deemed a "purchase" of Standard stock for Section 16(b) purposes to be matched against the sale of the same Standard stock within six months.

cidental is distinguishable because Occidental had no opportunity for access to inside information, while in the instant case there was such opportunity for access.[13]

The Occidental Opinion

To set the matter in perspective, a review of the *Occidental* case is in order.

That, too, involved a takeover situation with a contest for control and a defensive merger that defeated the takeover bid. After unsuccessful efforts by Occidental to induce the management of Old Kern to discuss a merger, Occidental on May 8, 1967 published an offer to purchase at $83.50 per share 500,000 shares of Old Kern for cash. Old Kern advised its stockholders not to tender. By May 10 more than 500,000 shares of Old Kern shares had been tendered. On May 11, Occidental, already a beneficial owner of more than 10% of Old Kern stock, extended its offer to encompass an additional 500,000 shares. Old Kern again advised its stockholders not to tender.

On May 19 Old Kern's directors announced their approval of a merger proposal from Tenneco, Inc. ("Tenneco") whereby Tenneco would exchange its own convertible preference shares said to be worth $105 per share for a transfer of Old Kern's assets to New Kern, a wholly-owned subsidiary of Tenneco.

On June 7 Occidental gave up the contest and granted Tenneco an assignable option to purchase 886,623 shares at a fixed price, the option being exercisable at any time after December 9, 1967, six months and a day after Occidental's last contemplated acquisition of Old Kern shares. Tenneco paid $10 per share for the option which it later

13 At this point we cite the case as *Occidental* (2 Cir.) rather than *Kern County* (Supreme Court) because Judge Lasker had before him at the time of his supplemental opinion of July 6, 1973 only the decision of this court. *Kern County* was not decided until May 7, 1974.

sold. On December 11, 1967, after the six months period had elapsed Occidental tendered its Old Kern shares for Tenneco preference stock. The assignee of the option then exercised the option, purchasing all the preference shares that Occidental had received on the exchange of stock under the Tenneco-Old Kern plan.

New Kern then sued Occidental for its "short swing" profits under 16(b) on two theories: (1) that Occidental had "sold" its Old Kern shares when at the August 30 closing between Old Kern and New Kern it became irrevocably entitled to Tenneco preference stock and (2) that the execution of the option agreement of June 2, 1967 constituted a "sale" by Occidental of the Old Kern shares.

I.

This court reversed a summary judgment in favor of New Kern and directed dismissal of the complaint. The holding concerning the option need not concern us here.[14] The holding that the exchange of Old Kern common stock for Tenneco convertible preference stock did not constitute a sale for 16(b) purposes is highly relevant, however, to our inquiry. In this regard, the similarity of *Occidental* to the case at bar is striking.

Judge Friendly, for the Court, essentially held that although in the "garden variety purchase and sale or sale and purchase within six months" the statute operates as a "crude rule of thumb," nevertheless, where there is a conversion of securities the court would look into whether "the conversion could have lent itself to speculative abuse." 45 F. 2d at 162.

This court noted that we had held an exchange of stock pursuant to the particular merger to be a sale for §16(b)

14 The court held that the granting of the option (a "call") was not a sale. The actual exercise of the option occurred after the six months period for 16(b) purposes had passed.

purposes in *Newark* v. *R.K.O. General, Inc.*, 425 F.2d 348 (2 Cir.), *cert. denied*, 400 U.S. 854 (1970). Judge Kaufman (now Chief Judge) had adopted a pragmatic approach in that case. This court was of the opinion in *Occidental* that "the indispensable predicate to the holding that the particular exchange there at issue was within § 16(b) was the finding that RKO's knowledge of the impending merger *coupled with the ability to control it* involved the possibility of speculative abuse with which § 16(b) was meant to deal." 450 F.2d at 163. (emphasis supplied).

The Supreme Court granted certiorari and affirmed. *Kern County, supra.*

We believe that *Kern County* holds the defensive merger situation to be *sui generis* in terms of § 16(b) liability. The implication is that the status of a defeated tender offeror affords no presumption of abuse of confidential information by virtue of relationship to the issuer. By status it is accordingly not "presumed to be an insider who will receive information regarding the company before it is made public." See *Chemical Fund, Inc.* v. *Xerox Corp.*, 377 F.2d 107, 110 (2 Cir. 1967). The adversary stance also rebuts the presumption of control.

In *Occidental*, this court was faced with a situation where the tender offeror had given up the fight. That it remained vulnerable to a defensive merger did not make it more of an "insider" than it had been before. Occidental had given up in the face of the Tenneco defensive merger. Crane had not. Instead, Crane had continued to fight for control and to try to defeat the Standard merger. We are now called upon to determine whether the difference in the reactions of Occidental and Crane to the respective defensive mergers makes a decisive difference. We think not. We think the similarities outweigh the differences.

As we noted in the *Occidental* case, tender offers "often operate to the great benefit of stockholders of the target corporation", 450 F.2d at 164. When sometimes the management of a company whose shares are held by many small stockholders becomes stolid and unprogressive to the detriment of its stockholders, tender offers for the company redound to their advantage. They are given a chance to sell out at a price above the market, stay with a new management, or become the beneficiaries of a possibly higher offer in a defensive merger.

The making of a tender offer after the terms of the merger have been announced puts the stockholder of the target company in an enviable position of choice with all the cards on the table under the proxy rules. To discourage such contests would tilt the scales against the small stockholder and in favor of management. His right to evaluate the competing securities offered in exchange would be frustrated. We see no public policy to be promoted in such case through the medium of Section 16(b).

Nor can we say that Crane would not have achieved control through its tender offer if Standard had not painted the tape to discourage tenders. We need not repeat Judge Smith's penetrating analysis in Crane I, supra. Suffice it to say that Crane apparently exerted its best efforts to win. If it had won, the defensive merger would not have come into being.

The important consideration is that the information Crane was likely to receive was in no way increased by its making of a tender offer. On the contrary, the sharpness of an open contest for control would make it even more an adversary. The terms of the merger it was opposing were known to all the stockholders of Air Brake as well as of Standard. The current financial conditions of both companies had become public property or would

soon become public property, depending on when the proxy statements were issued.

Just as Crane while a "beneficial owner" made its tender offer after the announcement of the Standard merger proposal, so Occidental, while a "beneficial owner", had extended its tender offer after the announcement of the Tenneco merger proposal. Old Kern, like Air Brake, had advised its stockholders not to tender. Like Air Brake, Old Kern had agreed to a defensive merger.

Crane, like Occidental, went to litigation in its attempt to win control. Crane, like Occidental, was an antagonist of the target company's management. Neither, despite "beneficial owner" status, had a single director of its choosing nor any control over the terms or timing of the merger.

The crucial question the Supreme Court faced in *Kern County* was a resolution of the difference of opinion on how far the automatic sanctions of § 16(b) should be applied to unorthodox transactions. It accepted the "pragmatic approach" that in merger situations the policy objectives of Congress in the enactment of Section 16(b) should be considered. *Kern County*, 411 U.S. at 594, n. 26.

The pragmatic test of borderline transactions had become "whether the transaction may serve as a vehicle for the evil which Congress sought to prevent—the realization of short swing profits based upon access to inside information." 411 U.S. at 594. The court did not rule that a merger may never result in a § 16(b) violation,[15] but it apparently distinguished *Newmark* v. *R.K.O. General, Inc.*, *supra*, and *Park & Tilford* v. *Schulte*, 160 F.2d 984 (2 Cir.); *cert.*

15 Contrary to the inference drawn by appellee, the court was careful not to state its caveat in terms of "defensive" mergers but rather of "mergers" generally. It is certainly true that mergers, as in *R.K.O.*, *supra*, can result in § 16(b) violations, as well as Rule 10b-5 violations. *Dasho* v. *Susquehanna Corp.*, 380 F.2d 262 (7 Cir. 1967), *cert. denied*, 389 U.S. 977 (1969).

denied, 332 U.S. 761 (1947), as cases where the defendant, unlike Occidental, had participated in or controlled the merger agreement or its equivalent. 411 U.S. at 599.

The emphasis in Mr. Justice White's opinion was on two factors: 1) The unlikelihood of actual access to inside information in an atmosphere of hostility by a party adverse in interest; and 2) the utter inability of the unsuccessful party to control the course of events. It is not enough that a sophisticated tender offeror may assume that if his bid fails because of a defensive merger he will probably profit if the defensive merger actually occurs. Such speculation is common but it is not the product of inside information. It is rather a sophisticated prophecy which is open to all public stockholders who possess no inside information whatever. Such a neutral prophecy is beyond the reach of § 16(b). Mr. Justice White noted that even the expectation that the public tender might increase the likelihood of a defensive merger is not related to the use of inside information unavailable to public stockholders. 411 U.S. at 598. In the words of Mr. Justice White:

> "If there are evils to be redressed by way of deterring those who would make tender offers, § 16(b) does not appear to us to have been designed for this task." 411 U.S. at 597-98.

The teaching of *Kern County* is that for Section 16(b) liability there must be a likelihood of access to inside information *"by reason* of its membership of more than 10% of the outstanding shares", 411 U.S. at 596 (emphasis supplied), that is, "by virtue of its stock ownership" 411 U.S. at 599. The otherwise casual acquisition of inside information through personal friendship and its use could be a violation of Section 10(b) and Rule 10b-5, but the irrebuttable presumption of § 16(b) should not be applied.

The very concept that stock ownership beyond a certain percentage makes the owner a statutory "insider" was based on the assumption that such percentage was enough to make him an "influential stockholder." [16] The 10% holder in the garden variety case is presumed to be "influential" as a friend of management or in control of some directors.

The essential policy objective of Section 16(b) is to prevent the *abuse* of confidential information by directors, officers and beneficial owners. Ordinarily, this simply requires a matching of the "sale" and "purchase," or "purchase" and "sale" in less than six months. When the setting is not one of control, but of its antithesis, the very weakness of the tender offeror in being unable to thwart the merger is further evidence that he does not control the target company's directors or stockholders.

We thus have a tender offeror who does not have access to inside information about the target company *by virtue of his position as a "beneficial owner"*, coupled with an inability, as further evidenced by the vote on the merger, to affect the course of the target company. It is this combination of circumstances that dictated the result in *Kern County* and dictates the conclusion on this appeal that the exchange of stock pursuant to the merger terms was not a "sale" for § 16(b) purposes.

We hold that whether the tender offeror quits fighting when the defensive merger is announced or continues to fight in the hope of winning, his exchange of stock on the merger after he has been defeated is not *ipso facto* a "sale" for § 16(b) purposes.

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16 Thomas Corcoran, testifying before the Senate Committee on Banking and Currency on February 23, 1934 said that the section (then numbered § 15) should apply "to every influential stockholder who, by reason of his position—and 5 percent is a lot of stock in a modern corporation—is on the inside of the circle." Hearing on Stock Exchange Practices, p. 6555.

We inquire then whether facts were presented below that overcame the controlling effect of *Kern County*.

In his first opinion, on cross-motion for summary judgment, the able District Judge had stated that "as to liability, there are no genuine issues as to material facts." 346 F. Supp. at 1155. The District Court phrased as the "preliminary but decisive" question: "Were there opportunities for speculative abuse?" 346 F. Supp. at 1157, 1159. In answering the question in the affirmative, it relied simply on the general knowledge of all tender offerors rather than on any specific knowledge by Crane. Indeed, in stating the facts of the *R.K.O.* case, *supra*, the District Court noted, as one of the salient facts, that R.K.O. "had knowledge of the merger" and characterized this as "facts not present in the instant case." 346 F. Supp. at 1160. Judge Lasker made no mention of any contention of Standard that Crane had particular knowledge beyond the general knowledge that a tender offeror normally has. When the recent decision in *Occidental* by this court was called to his attention the Judge did not distinguish it upon the ground that here Crane had greater access than Occidental had possessed.

We have examined the briefs which were filed by Standard in the District Court six weeks after our decision in *Occidental*. Nowhere was there pressed upon Judge Lasker the present contention that "the evidence shows that Crane had access to, and in fact possessed, confidential information about Air Brake and its successor" (Point I A, Standard's Brief).[17] On the contrary, Standard

17 The omission may have been a sophisticated stratagem by Standard's able counsel to prevent an issue of fact from arising which might preclude summary judgment in its favor on what it thought were winning grounds. In its statement of material facts pursuant to General Rule 9(g) of the District Court Standard listed three facts as to which there

relied on the argument that "Crane's aggressive participation in a prolonged corporate struggle" was in contrast to "Occidental's role as a mere bystander." The point made was that Crane, by continuing its purchases after public knowledge of the merger, took advantage of the Air Brake stockholders because Crane had to know that the proposed merger would make the stock go up, but not because it was in a position to be "fed" inside information.

Nor was the 9(g) statement under the local rules of the Southern District on motions for summary judgment amended by Standard to show accessibility to inside information either as a disputed or as a conceded fact.[18]

Since we have found upon the record as presented by Standard that there was no accessibility of Standard to Air Brake inside information "by reason of its ownership of more than 10% of the outstanding shares" *Kern County*, 411 U.S. at 596, we need not decide whether we are foreclosed on appeal from considering the facts tendered by Standard which it failed to call to the attention of the

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exist genuine issues to be tried but failed to list whether Crane, in fact, had the possibility of access to inside information. We can hardly say that this was an unwise gamble.

18 Rule 9(g) of the "General Rules of United States District Courts for the Southern and Eastern Districts" reads as follows:

"Upon any motion for summary judgment pursuant to Rule 56 of the Rules of Civil Procedure, there shall be annexed to the notice of motion a separate, short and concise statement of the material facts as to which the moving party contends there is no genuine issue to be tried.

"The papers opposing a motion for summary judgment shall include a separate, short and concise statement of the material facts as to which it is contended that there exists a genuine issue to be tried.

"All material facts set forth in the statement required to be served by the moving party will be deemed to be admitted unless controverted by the statement required to be served by the opposing party."

District Court on the motion for summary judgment. We leave that question to another day.[19]

II

We now turn to the contention that the "purchase" for § 16(b) purposes was the exchange of Air Brake common shares for Standard convertible preference shares and that the "sale" was the sale of those shares within six months.

We have already stated the reasons why we find the exchange pursuant to the merger not to have been a "sale" of the Air Brake shares, and we include as a factor the nonvolitional character of the exchange. It would be anomalous, for the same reasons, to hold the identical transaction a "purchase" of the Standard shares.

In *Gold* v. *Sloan*, 486 F.2d 340, 344 (1973), *cert. denied*, 43 U.S.L.W. 3212 (Oct. 15, 1974), the Fourth Circuit held, in a decision rendered after *Kern County*, *supra*, that whether the exchange of stock pursuant to a merger is a "purchase" is not subject to an "automatic rule," "but each transaction must be adjudged on its own particular facts and in the light of the evil which Congress sought by the statute to prevent." In *Gold* the exchange of stock in a merger was held to be a "purchase" by one defendant, though not by other defendants.[20] The facts with respect to the defendant held liable under Section 16(b) came within the reach of *R.K.O.*, *supra*. In that type of case an exchange on a merger can be a "purchase" as well as a "sale." But in a *Kern County* type of case it would make no sense

19 We surely cannot approve a practice, however, of dumping an extensive record on a busy District Judge without guidance from counsel, expecting him to ferret out facts which might conceivably be relevant on a motion for summary judgment.

20 *Gold* did not involve a defensive merger, nor a "beneficial owner." It involved a voluntary merger in which the defendant held liable was the principal negotiator.

to treat a transaction held not to be a "sale" to be a "purchase."

On the contrary, holding the exchange pursuant to merger to be a "purchase" would allow the successful party to lock in the defeated tender offeror for six months post-merger. That would act as a powerful deterrent on tender offers, many of which involve the payment of substantial interest to lending banks.

The District Court did not specifically rely on this contention of the appellee. It emphasized, rather, the matching of the purchase of Air Brake shares for cash and the sale for cash after the exchange pursuant to the merger of the Standard stock received on the exchange.

III

We turn then to the District Court's determination that the cash sale by Crane of the *Standard Preference Stock* it acquired on the merger should be matched against its purchase of a different stock, *Air Brake common* within six months of the sale. We have found no case in which the sale of the stock of the successor corporation was matched against the purchase of the stock of the acquired corporation to spell § 16(b) liability.[21] We must consider the decision below rendered in July, 1972 as one of first impression.[22]

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21 The decision below is said to be the first case so to hold. See Posner, *Developments in Federal Securities Regulation*, 29 Bus. Lawyer 3, 38 (1973).

22 *Blau* v. *Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966) involved only a question of standing to sue. A stockholder of a successor corporation by merger was held to have standing to sue for recovery of profits of a director who purchased and sold, within six months, the stock of the acquired company. The successor corporation had succeeded to all the assets of the acquired corporation, including the § 16(b) claim. Judge Weinfeld held that its stockholders could sue in a direct action under § 16(b). *Oppenheim* was cited with approval by this court, but

Standard, in its amended complaint, fairly alleged the matching of the transactions mentioned as affording a claim for relief, and Crane adequately countered by defending on the ground, *inter alia*, that the § 16(b) claim did not, in any event, belong to plaintiff Standard. On this aspect of the case there is surely no factual dispute, and the issue is ready for summary judgment.

The issue is whether Section 16(b) permits a statutory liability to attach by matching the purchases of the shares of one "issuer" against the sale of shares of another "issuer." [22]

The appellant makes a number of other contentions as well. Appellant contends that § 16(b) does not apply to Crane's sale of Standard preference stock because that stock was at the time unregistered and exempted from § 16 of the Act and, alternatively, because the convertibility of the Standard preference stock did not confer on Crane the status of beneficial owner of Standard common. As an

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only on the question of standing. *Newmark* v. *R.K.O. General, Inc., supra*, 425 F.2d at 352, n. 4. In *Western Auto Supply Co.* v. *Gamble-Skogmo, Inc.*, 348 F.2d 736, 739-40 (1965), *cert. denied*, 382 U.S. 987 (1966), the Eighth Circuit treated the question as one of survivability of the cause of action. The *Oppenheim* case has been construed by a commentator "as relating solely to the issue of standing and is of dubious precedential value for the conclusion that equity securities of different entities should be matched in order to invoke liability under the statute." Lang & Katz, *Section 16(b) and Extraordinary Transactions*, 49 Notre Dame Lawyer 705, 703 (April 1974).

23 For purposes of this discussion we assume, without deciding, that the immediate right of Crane to convert its preference shares into common requires the computation of its more than 10% beneficial ownership on the basis of a hypothetical conversion which would have made Crane a 15% holder of the issued and outstanding Standard common stock. We note SEC Rule 16a-2(b) without passing on its applicability or validity. This is not to say, in any event, that a sale of the preferred stock is a "sale" of the underlying common. We do not reach that question here. Cf. *Chemical Fund* v. *Xerox Corp.*, 377 F.2d 107 (2 Cir. 1967); *Simon* v. *Sunasco Co., Inc.*, CCH Fed. Sec. L. Rep. ¶92,547 (S.D.N.Y. 1970).

additional factor, it relies on the argument that, in the particular circumstances, Crane would have been unable to convert into Standard common because that would have involved a violation of the federal antitrust laws. Crane carries the antitrust point further by contending that its sale of the Standard stock was effected under antitrust compulsion which absolves it from § 16(b) liability.

Appellant contends as well that its sale of the Standard stock was a result of Standard's fraudulent market manipulation and that Standard should not be permitted to profit from its own wrongdoing.

We do not find it necessary to decide these issues in view of our disposition of the matter upon the grounds discussed in this opinion.

The Statute

Subdivisions (a) and (b) of Section 16 are grammatically interrelated and must, therefore, be read together for coherence. In pertinent part they provide:

> "(a) Every person who is . . . the beneficial owner of more than 10 per centum of any class of any equity security . . . which is registered pursuant to section 781 of this title, . . . shall file . . . within ten days after he becomes such beneficial owner, . . . a statement with the Commission . . . of the amount of all equity securities *of such issuer* of which he is the beneficial owner. . . . (Emphasis supplied).
>
> "(b) For the purpose of preventing the unfair use of information which may have been obtained by [such beneficial owner] by reason of his relationship *to the issuer*, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security *of such issuer* . . . within any period of less than

six months . . . shall inure to and be recoverable *by the issuer.* . . . Suit to recover such profit may be instituted . . . *by the issuer,* or by the owner of any security *of the issuer.* . . ." (Emphasis supplied).

Section 3(a)(8) of the Act defines "issuer" as "any person who issues or proposes to issue any security."

The statute speaks of "such issuer" in the singular. There is no room for a grammatical construction that would convert the singular into a plural. Nor does the internal construction of the section lend itself to such a free interpretation. For if the "issuer" is Air Brake, the insider profits "recoverable by the issuer" would not be the profits on the sale of its own stock but of the stock of a different "issuer"—Standard. If the "issuer" is Standard, "any profit realized by him from any purchase and sale . . . of any equity security *of such issuer*" does not cover the purchase of an equity security of another "issuer"—Air Brake.

The literal inapplicability of the statute was not involved when the claim was that the exchange on the merger was itself the "sale" for matching purposes. *Newmark* v. *R.K.O. General, Inc., supra,* for in such case the "equity security" purchased and sold was the same security, that of the original "issuer." Nor was it posed when the claim was that the exchange on the merger was itself the "purchase" for matching purpose with a subsequent sale. *Gold* v. *Sloan, supra,* for there too the matched securities are of the *same* "issuer", the successor corporation.

When, however, as here and in *Kern County, supra,* the exchange of stock on the merger is held to be neither a "sale" nor a "purchase" for Section 16(b) purposes, reliance must be had by Standard solely on the subsequent sale of Standard preferred shares matched against the earlier purchase of Air Brake stock.

As applied to beneficial owners, as distinguished from officers and directors, § 16(b) provides:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of purchase and sale, or the sale and purchase of *the* security involved." (Emphasis supplied).

"Such" refers back to subsection (a) requiring the filing "of the amount of all equity securities of *such issuer* of which he is the beneficial owner." (Emphasis supplied). The style and substance lead to the conclusion that Congress was concerned with a single issuer.[24]

The literal meaning is that of beneficial ownership of the *same* security at the time of purchase and sale. While the statement of statutory purpose would not necessarily defeat a normal reading of the statute, cf. *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 236 (2 Cir.), *cert. denied*, 320 U.S. 751 (1943), the converse is not true when the statement supports the normal reading. The statutory purpose of § 16(b) is to prevent the abuse of inside information "by reason of his relationship to the issuer." At the time of purchase Crane had no relationship to Standard.

While the legislative history affords no explanation of the purpose of the proviso, the majority opinion in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972), suggests that "it may be that Congress regarded one with a long-term investment of more than 10% as more likely to have access to inside information than one who moves in and out of the 10% category. But whatever the rationale of the proviso, it cannot be disre-

24 This has been the view of commentators. See e.g., 117 Pa. L. Rev. 1034, 1052 (1969), Lang and Katz, *supra*, 49 Notre Dame Lawyer at 721-24.

garded simply on the ground that it may be inconsistent with our assessment of the 'wholesome purpose' of the Act." [25]

To consider the argument that "such issuer" may be construed to include a successor in interest by merger, several tools of interpretation, in addition to the grammatic reading, may be employed, such as 1) the judicial gloss on the statute by earlier judicial interpretation; 2) the legislative history; 3) the standards of statutory interpretation; 4) whether the statutory interpretation will in cases likely to arise serve as a good or bad precedent; and 5) the ease of statutory amendment if the Congressional views on policy differ from the judicial views.

1. In *Abrams* v. *Occidental, supra,* this court rejected the view that Section 16(b) should be mechanically applied "across the board, even to situations that Congress scarcely considered." 450 F.2d at 162. Judge Friendly (then Chief Judge) noted that we had been freed from the restrictive dictum of *Park & Tilford,* 160 F.2d 984, 987 by a series of cases beginning with the holding of Judge Stewart (as he then was) in *Ferraiolo* v. *Newman,* 259 F.2d 342, 346 (6 Cir. 1958) down through this court's consideration of the approach to § 16(b) in *Blau* v. *Lamb,* 363 F.2d 507 (2 Cir. 1966).

We shall not review all the cases that support, in the happy phrase of Judge Hastie, a "rule of reason" [26] in unorthodox transactions but we point to the culmination of the so-called "subjective approach" in *Kern County.*

We note that Crane did not acquire a controlling interest in Standard, had no representation on Standard's

25 In *Reliance, supra,* the facts disclosed that Emerson was "forced" into its successive "sales" by a defensive merger. See Note, 87 Harv. L. Rev. 291, 295, n. 29.

26 Hastie, *J.*, dissenting in *Heli-Coil Corp.* v. *Webster,* 352 F.2d 156, 174 (3 Cir. 1965).

Board of Directors, lacked sufficient voting power to elect a director and apparently had no intention of seeking such representation.

Examination of the possibility of abuse in the transaction to determine whether it should come within the automatic ban ascribed to § 16(b) by cases (in language at least) like *Park & Tilford* v. *Schulte, supra,* has thus far been limited to situations where there has been a "conversion" of securities rather than a purchase or sale for cash.

Such a nonobjective approach has been applied to exchanges involving securities of the same issuer, e.g., *Blau* v. *Lamb,* 363 F.2d 507 (2 Cir. 1966); and see *Roberts* v. *Eaton,* 212 F.2d 82, 83-86 (2 Cir. 1954), *cert. denied,* 384 U.S. 827 (1959); *Pettys* v. *Butler,* 367 F.2d 528 (8 Cir. 1966); as well as to the exchange of securities in a merger, *Newmark* v. *R.K.O. General, Inc., supra; Abrams* v. *Occidental, supra, aff'd sub nom. Kern County, supra; Gold* v. *Sloan, supra.*[27]

The reason why this broader approach has been limited to such cases is not hard to find. For if the matter upon examination turns out to be within the proper scope of § 16(b), the *exchange* of shares pursuant to the merger is itself found to be the "sale" matched against an earlier purchase for cash, as in *R.K.O., supra;* or the *exchange* is found to be the "purchase" matched against a subsequent sale for cash of the same security. *Gold* v. *Sloan, supra.*

27 "In 1966, the conversion problem largely became moot when the Commission adopted Rule 16b-9, which exempted from the operation of § 16(b) any acquisition or disposition involved in a conversion of one equity security into another of the same corporation. Thenceforth, the controversy would center upon merger situations, creating the necessity of reexamining the problem of volition." Weinstock, 29 Bus. Lawyer 1153, 1160 (1974).

In such cases the need to match the securities of different issuers could hardly arise, since one of the two requisite components—purchase or sale—would, by hypothesis, have been found to inhere in the *exchange* itself.

2. The legislative history of Section 16(b) of the 1934 Act has been studied by courts in many cases. See, e.g., *Kern County, supra; Smolowe* v. *Delendo Corp.*, 136 F.2d 231 (2 Cir. 1943) (Clark, *J.*); *Blau* v. *Lamb, supra, Pettys* v. *Butler, supra.*

The rather short legislative history of the present § 16(b)[28] indicates that this "anti-Wiggin statute"[29] as it was popularly called, dealt with the speculative practices of those captains of finance who had taken advantage of confidential inside information to trade in the securities of *their own* companies to the abuse of their own "outside stockholders." Congress was concerned about the "outside" owners of securities which were being cavalierly traded by fiduciaries whom the stockholders had elected to positions of trust. The stress was on fiduciary responsibility. The purpose of § 16(b) was to prevent directors, officers and principal stockholders "from speculating in the stock of the corporations to which they owed a fiduciary duty." S. Rep. No. 1455, 73rd Cong. 2d Sess. 68 (1934).[30] Congress imposed liability for his profits upon

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28 In draft form it was early called § 15(b).

29 See Report of House Committee on Interstate and Foreign Commerce, 73rd Cong. 2d Sess. Report No. 1383 p. 13 (1934).

30 "The undoubted congressional intent in the enactment of § 16(b) was to discourage what was reasonably thought to be a widespread abuse of a fiduciary relationship." Judge Burger (now Chief Justice) in *Adler* v. *Klawans*, 267 F.2d 840, 844 (2 Cir. 1959). As Professor Loss notes, the "inure to" phrase in § 16(b) suggests the concept of a constructive trust. Loss, *Securities Regulation*, 1042 n. 17 (1961). See Cook and Feldman, *Insider Trading Under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 408 (1953). See Munter, *Section 16(b)*, 52 Corn. L. Q. 69-71 (1966).

the statutorily presumed faithless trustee without proof of actual loss. The profits were to be restored to the presumptively aggrieved *cestui que trust*, the issuer of the securities. The prize could be given to no other, for an alternative would have required proof of actual injury. If the asset of the corporation—secret information—was improperly taken, the profits were to be restored to the *cestui*. See Judge Learned Hand in *Gratz* v. *Claughtons*, 187 F.2d 46, 49-50 (2 Cir. 1951), *cert. denied*, 341 U.S. 920 (1951).[31] The beneficial owner concept was intended simply to expand the class of putative fiduciaries. After hearings on stock market practices the Senate Banking and Currency Committee reported in 1934:

> "... Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others." [32]

The successor corporation in a merger is hardly the *cestui* who was wronged.[33] The stockholders of the acquired corporation, aside from the defendant, may have only a small interest in the equity of the surviving corporation. They would share only in a relatively small proportion in any recovery by the successor.[34]

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31 In Judge Hand's words: "... § 16(b) in effect made 'beneficial owners' fiduciaries as directors and officers were anyway." 187 F.2d at 49.

32 Stock Exchange Practices, Report of Com. on Banking & Currency, S. Rep. No. 1455, 73d Cong., 2d Sess. (1934) 55.

33 See separate opinion of Winter, *J.*, in *Gold* v. *Sloan*, 486 F.2d 340 at 355.

34 On the present appeal we deal with a situation where about two-thirds of the common stock of Standard after the merger was owned by

While every § 16(b) recovery may be deemed to partake of windfall there is ample justification in legislative purpose for restoring the recaptured profit to the issuer itself. See *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308; *Diamond* v. *Oreamumo*, 24 N.Y. 2d 494, 499 (1969). There is nothing but sheer windfall, however, in handing it to the successor corporation.[35] That corporation was not in *any relationship with Crane before the merger except that* of competitor for control of Air Brake. Standard's determination of the ratio of exchange in a merger it controlled was of its own making in negotiation with Air Brake. If the purchases by Crane of Air Brake stock incidentally affected the number of Air Brake stockholders who ultimately voted for the merger, such activities were legal and hardly within the prohibitory scope of § 16(b). See *Kern County, supra*, 411 U.S. at 597-98.

3. In the legislative history we have observed no omission by inadvertence. But even if there had been inadvertence, as Justice Brandeis wrote in another context, "[w]hat the Government asks is not the construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included in its scope." *Iselin* v. *United States*, 270 U.S. 245, 251 (1926).

Appellees do not suggest that we rewrite the statute. That we cannot do. See *Packard Motor Co.* v. *National*

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persons who had no relationship whatever to Air Brake before the merger. They could hardly be described as *cestuis of* Crane. *Per contra*, all the former stockholders of Air Brake, aside from Crane, owned approximately no more than 20% of the equity on the basis of a hypothetical conversion of all the preference shares.

35 That is, except where recovery is based on assignment from the dissolved corporation of a § 16(b) claim already matured for which it is assumed some consideration will have been paid in the merger exchange. See, e.g., *Reliance Electric Co.* v. *Emerson Electric Co., supra.*

Labor Relations Board, 330 U.S. 485, 492-93 (1947). As Mr. Justice Stewart said in *Reliance*, *supra*, ". . . we are not free to adopt a construction [of § 16(b)] that not only strains, but flatly contradicts, the words of the statute." 404 U.S. at 427.

The appellee argues that "issuer" should be read as if it said "corporation" and that a successor in interest by operation of law thus comes within the term. The difficulty is that the term "issuer" was the term of art selected by the Congressional draftsmen because it relates to its own registered "equity securities." Section 16(b) is not a statute dealing with corporate assets whatever they may be. The functions of registration and reporting are meaningful only in relation to the specific "issuer."

While a legal successor in interest, indeed, has standing to recover, it does so only as successor to a claim already matured, a chose in action of the acquired corporation. Cf. *Western Auto Supply Co.* v. *Gamble-Skogmo, Inc.*, *supra*.

4. While we believe that our interpretation of the statute is compelled, we pause, nevertheless, to assess as best we can, its impact for the future. Although Section 16(b) is now forty years old, the precise question has never before been presented for decision nor is it likely to arise except in contested tender offer situations. When more than 10% of the subsequently acquired stock has been purchased within the six months before the effective date of the merger, and the tests of the *R.K.O.* decision have been met, there will be no problem, for the exchange itself will be the end rather than the beginning of the matching process. In mergers where the defendant is the opposing party in the contest for control and the test of *Kern County* is met, a sensible policy should permit the losing contender to divest itself of stock in the successor company, for it did not intend that company to be its investment vehicle. To make

it hold on to the stock which it received in exchange would be to compel it to subject itself to the vagaries of the market, and probably to the continued payment of interest to a lending institution as a penalty for losing the contest for control. The enemy of yesterday is not the friendly insider of tomorrow. The enmity would hardly be dissolved by the merger unless some new deal were made for access to confidential secrets and control. A defensive merger may create a practical armistice but it is far short of being a treaty of peace.

We are satisfied, therefore, to hold as we do in this defensive merger situation, without fear of undesirable precedential effect.

5. While most, if not all, "beneficial owners" (other than those engaged in adversary contests for control) would be caught in the web of Section 16(b) simply by treating the *exchange* on the merger as a "sale" or a "purchase," there may be some other hypothetical situations that do not readily come to mind in which our reading of § 16(b) might not be in accord with the statutory purpose. It is better that any such hypothetical situations be covered by legislative action, whether it be by amendment of § 16(b) or in a new statute.

The proposed ALI Federal Securities Code, under the able guidance of Professor Louis Loss, has thus far in the draft statute not extended the *automatic* sanction of Section 16(b) to mergers. While the draft makes no mention of the "defensive merger" situation as such, it would add to present law a specific statutory provision permitting matching if the securities involved have "more than one issuer," § 1413(g), providing, however, that "if the defendant proves that he did not use information obtained by reason of his relationship to an involved issuer", he is relieved of liability under § 1413(h). This addition to existing statutory law,

in any event, would not apply the irrebuttable presumption of the present Section 16(b) to such transactions involving "more than one issuer."[36]

There has, indeed, been some comment to the effect that "before the development of Rule 10b-5 there was a legitimate reason for expanding the coverage of § 16(b) and applying it flexibly, but that reason no longer exists. The 'possibility of abuse' test operates with no more certainty or simplicity than does Rule 10b-5; yet its application does not disclose actual inside speculation." Note, *Reliance Electric and 16(b) Litigation: A Return to the Objective Approach*, 58 Va. L. Rev. 907, 928 (1972). See also Lowenfels, *Section 16(b): A New Trend in Regulating Insider Trading*, 54 Corn. L. Rev. 45, 61-64 (1968).

Lastly, we note that the policy issue, of recent development, lends itself to legislative consideration. The stronger emphasis on the abuse of inside information for speculative purposes exemplified by *SEC* v. *Texas Gulf Sulphur*, 401 F.2d 833; 446 F.2d 1301, coupled with the legislative concern with tender offers, Securities Exchange Act § 14(d), 15 U.S.C. § 78n(d), Act of July 29, 1968, Sec. 3, 82 Stat. 456, added in the Williams Act, indicate that reliance on Section 16(b) as the key tool in merger situations may not necessarily be desirable. See Lowenfels, *supra*. It is Congress which can make any contrary policy decision.

For the foregoing reasons the order granting partial summary judgment against Crane is reversed, and the cause remanded with instructions to enter judgment dismissing the complaint.

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36 ALI Federal Securities Code, Tentative Draft No. 2 (1973).

APPENDIX B

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
74-1233

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the twentieth day of December one thousand nine hundred and seventy-four.

Present:

HON. LEONARD P. MOORE
HON. JAMES L. OAKES
HON. MURRAY I. GURFEIN
Circuit Judges

—o—

AMERICAN STANDARD, INC.,
Plaintiff-Respondent,

v.

CRANE CO.,
Defendant-Petitioner and Third-Party Plaintiff-Appellant

v.

EDWARD J. HANLEY, *et al.*,
Third-Party Defendants.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

—o—

Appendix B—Judgment of the Court of Appeals

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and that the action be and it hereby is remanded to said District Court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellee.

A. Daniel Fusaro,
Clerk

By Vincent A. Carlin,
Chief Deputy Clerk

Docketed as a judgment # 75,073 on Jan. 22, 1975

APPENDIX C

Opinion of the District Court

UNITED STATES DISTRICT COURT,

S. D. NEW YORK.

No. 68 Civ. 2461.

—o—

AMERICAN STANDARD, INC.,

Plaintiff,

v.

CRANE CO.,

Defendant and Third-Party Plaintiff,

v.

EDWARD J. HANLEY *et al.*,

Third-Party Defendants,

and Two Other Consolidated Actions.

—o—

Oct. 12, 1971.

OPINION

LASKER, *District Judge.*

In the spring of 1967 the fancy of Crane Co. ("Crane") lit upon Westinghouse Air Brake Co. ("Air Brake") as an attractive take-over candidate. As is often the case in corporate, as in amatory, affairs, the pursued was unwilling. Air Brake rejected its suitor and turned elsewhere for marriage and protection. American Standard, Inc. ("Standard") found Air Brake as appealing a partner as had Crane, competed for the favored hand and won.

This litigation between the rejected and favored suitors—not the first battle between them on the subject—grows out of that courtship.

Standard sues under § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) ("the Act") to recover short swing profits made by Crane in its dealings in the stock of Air Brake. The case presents the following questions:

> 1. Do the facts establish that an opportunity for speculative abuse by Crane existed?
>
> 2. If so, do Crane's dealings in Air Brake stock constitute sales (or purchases) within the meaning of the Act?
>
> 3. Did the Court of Appeals, in other litigation between the parties [Crane Company v. Westinghouse Air Brake Company, et al., and Crane Company v. American Standard, Inc. et al., 419 F.2d 787 (2d Cir. 1969)], determine that Standard's acts forced Crane to sell?
>
> 4. If so, does that finding prevent Standard from recovering from Crane on the theory of estoppel or otherwise?

I.

On these cross-motions for summary judgment [1] as to liability, there are no genuine issues as to material facts,

[1] Plaintiffs Henry Abrams and Melvin Kritzler (in the two actions consolidated herewith), former stockholders of Air Brake, have submitted a memorandum and affidavits in opposition to Crane's motion and in support of Standard's. As an alternate position they argue that, even if the court holds, for reasons to be discussed later, that Standard is estopped from recovering from Crane, Crane should nevertheless be held liable to the former stockholders of Air Brake.

but the facts are complex and must be outlined in some detail for an intelligent understanding of the case.

In June 1967, Crane embarked on a program of buying Air Brake stock. In late 1967, Crane, not yet a 10% stockholder of Air Brake, proposed to Air Brake that it be merged into Crane. In December, Air Brake declined the proposal. Although Crane then briefly discontinued its purchases of Air Brake, it resumed them vigorously in January. By January 26, 1968, it held 463,000 shares, more than 10% of the 4,594,161 shares outstanding. On February 20, 1968, Crane filed 14-B statements with the Securities and Exchange Commission declaring its intention to solicit proxies to elect directors to Air Brake's board. This action sparked counter action by Air Brake in the form of discussions with Standard as to a merger of Air Brake into Standard. On March 4, 1968, the president of Standard advised Crane's chairman that agreement had been reached on a Standard-Air Brake merger, and the following day the announcement was made to the public.

Although Crane's chairman remarked at the time[2] that such a merger would cause Crane to become a stockholder of Standard, which "looked like an impossible situation," Crane decided to fight it out with Standard and continued its program of buying Air Brake stock. On April 6, 1968, Crane publicly announced its tender offer for all the outstanding stock of Air Brake.

Crane's tender offer to exchange a package of its stock and debentures totaling $50 in face amount for a share of Air Brake was mailed during the week of April 8. Through its tender offer Crane secured over 500,000 Air Brake

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[2] Deposition of Thomas M. Evans, May 10, 1968, p. 32, in Crane Co. v. Westinghouse Air Brake Company, et al., 68 Civ. 1560.

shares in April and more than 250,000 within the following month, so that it finally owned 32% of the stock. By its terms the offer expired April 19 at 5:00 P.M. On April 10, Air Brake was selling at about $49.

On the day that the Crane tender was to expire, Standard purchased 170,000 shares of Air Brake on the New York Stock Exchange at an average price of $49.50, and on the same day sold 100,000 shares on the market and 20,000 shares on the market at a negotiated average price of $44.50 for a loss of over $500,000 on its transactions for the day. The Court of Appeals of this Circuit has described Standard's April 19th activities and their result as follows:

> "The critical day in the take-over battle was April 19, the day Crane's tender offer for Air Brake stock was to expire. The holders of Air Brake stock could be expected to delay until the last moment in order to make a decision based on the latest market information, i. e., to compare the value of the tender offer, here not more than $50, with the market price on the day the offer was to expire. In fact, 85 percent of the shares tendered to Crane by the 19th were offered on that day. [citation] On April 19, Air Brake opened at 45¼ on the New York Stock Exchange, giving Crane's tender offer a good prospect of success. The surest way to defeat the Crane offer was to run the price up to $50. The tape did quickly reach $50 on April 19, and Crane's tender offer failed. Crane's claim that this was the result of extraordinary transactions by Standard is supported by the record.
>
> ". . . The net result of this buying was to represent to the public, whose primary source of infor-

mation is the tape, that there was a great demand for Air Brake at an increased value. It is reasonable to conclude that many Air Brake stockholders who might otherwise have chosen to tender to Crane chose not to do so because their own holdings in Air Brake looked better as the price went up.

". . . Standard had 'painted the tape' in Air Brake stock. . . .

"Standard's extraordinary buying here, coupled with its large secret sales off the market, inevitably distorted the market picture and deceived public investors, particularly the Air Brake shareholders." Crane Company v. Westinghouse Air Brake Company, et al., 419 F.2d 787, 792-793 (2d Cir. 1969).

On or about May 16, 1968, the Air Brake stockholders voted to approve the merger with Standard. On June 7 the merger became effective and the Standard preference stock was exchanged for Air Brake common. Between June 7 and June 13, Crane exchanged its then holdings of 1,480,623 Air Brake shares for 740,311 of Standard, and on June 13 sold 730,311 shares of Standard on the New York Stock Exchange for $76,134,921.75 at a profit estimated at over $10,000,000. Shortly thereafter Crane sold 9,000 of its remaining 10,000 shares.

In late May, prior to the consummation of the merger, Crane had brought two suits against Air Brake and Standard, the first to enjoin the merger, the second—with which we are concerned in this case and to which reference has been made above—charging Standard with manipulation in violation of the Securities Exchange Act of 1934. The first suit, as is evident from the fact that the merger was consummated, was dismissed on June 5 after trial.

III.

A. *Were there opportunities for speculative abuse?*

Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p(b)) provides:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months.[3]

Its purposes and effects have been analyzed in a number of significant opinions, most recently in the succinct statement of Judge Kaufman writing for the Court of Appeals of this Circuit in Newmark v. RKO General, Inc. and Frontier Airlines, Inc., 425 F.2d 348, 350-351 (1970):

> "Commonly termed a 'crude rule of thumb,' the statute seeks to prevent insiders from realizing profits on securities held for short periods of time. It is not aimed solely at the actuality of evil, or the veritable employment of inside information for

[3] The section applies to "every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security . . ." registered pursuant to the Act.

purely speculative purposes, but also at *potentiality* for evil inherent in all insider shortswing trading." (emphasis added).

"To maximize its deterrent effect, the section is drafted in clear, straightforward terms. It provides that whenever a director, officer or owner of ten percent or more of any class of an issuer's securities purchases and sells equity securities of that issuer within a six-month period, he must return any profits he realizes to the issuer. There are no other prerequisites or postulates to liability."

The comprehensive reach of the § 16(b) tabu was earlier characterized by the Court of Appeals as follows:

"In order to insure discouragement of unfair insider short term trading *all* inside trading within a less-than-six-month period is discouraged. The arbitrary, some might say Draconian, nature of this statute reflects the view of experts who testified at the hearings leading to the passage of the 1934 Act that the use of information by corporate insiders could only be effectively curbed by a law that made it unprofitable for insiders to engage in any short term trading, whether fair or unfair. It might be said that Congress decided in order to throw out the bathwater that the baby had to go too." (emphasis in original). Blau v. Lamb, 363 F.2d 507, 515 (2d Cir. 1966).

In spite of the breadth of this construction of § 16(b) and a reiteration of earlier holdings that the section applied to conversions of securities as well as to cash transactions, the Court nevertheless raised the important question whether § 16(b) could be held to apply to a "transaction

. . . which could not possibly serve as a vehicle for any of the abuses at which Section 16(b) was aimed." The answer was that it could not, and this construction necessarily required a preliminary inquiry as to whether the accused transaction could "possibly" fall within the guilty category. On this point the *Blau* court observed, at 519:

> "Congress adopted the sweeping, arbitrary regulatory mechanism embodied in Section 16(b) in order to insure that even the *possibility* of insider abuse was deterred, but it would seem to follow that in order to avoid 'purposeless harshness' a court should first inquire whether a given transaction could *possibly* tend to accomplish the practices Section 16(b) was designed to prevent. . . . Frequently this initial inquiry will convince a court that the transaction in question held out at least the possibility of abuse; in such cases Section 16(b)'s regulatory mechanism requires that the section be applied without further inquiry. In some cases, however, this critical inquiry will convince a court that the conversion transaction in question could not possibly have lent itself to insider abuse. In such a case it is not inconsistent with Section 16(b)'s regulatory mechanism to hold that the section does not apply." (emphasis added).

The requirement of a threshold determination was reiterated in *Newmark* v. *RKO General, Inc., supra,* 425 F.2d at 351:

> "Only when an opportunity for speculative abuse is present is it necessary to determine whether the transactions alleged to give rise to 16(b) liability may fairly be characterized as insider purchases and sales."

We turn, therefore, to the preliminary but decisive question of whether an opportunity for speculative abuse inhered in Crane's transactions in Air Brake stock.

It is natural that Crane contends that no possibility for speculative abuse existed in the unique set of facts before us. The heart of Crane's argument is that Crane was not only a forced seller, but that, in the circumstances, and particularly in light of Standard's unexpected manipulative acts of April 19, it had no power to determine whether the merger would take place, and, the merger being forced on it, there was no possibility for Crane to speculate. In order to engage in short term speculation, Crane asserts, the trader must have the power to decide whether and when to buy or sell.

In answer, Standard asserts: Since nearly all merger announcements bring about a rise in the market price of a merging company, Crane stood to win, and knew it stood to win, whether or not it acquired control of Air Brake; if it succeeded in the control battle, it gained a major business objective; if it did not, it would make exactly the kind of insider profit that § 16(b) outlaws. The exchange ratio, Standard argues, when publicly announced (as it inevitably would be) would have a predictably beneficial effect on the price of Air Brake stock. Crane knew prior to March 4 that this would occur and was in a position to exploit the knowledge. Thus it had precisely the unfair trading advantage vis-a-vis unknowing members of the general public which the section condemns. This is Standard's riposte to the transactions involving the Air Brake shares which Crane acquired before April 19.

As to the shares purchased by Crane after that critical date (491,861 shares, purchased part on April 29, May 14 and May 24, at a cost of over $24,000,000), Standard contends that Crane's argument that Standard's acts put be-

yond Crane's power the determination whether the merger would take place is altogether inapplicable or, if it is applicable, then the only reason Crane could have for buying after April 19 was pure speculation.

We hold that opportunities for speculative abuse did inhere in Crane's transactions. We start from the statutory presumption, emphasized in Chemical Fund, Inc. v. Xerox Corporation, 377 F.2d 107, 110 (2d Cir. 1967), that

> " . . . section 16 is specifically concerned with 'directors, officers and principal stockholders,' and has adopted a rule that any stockholder owning more than 10 percent of an equity security is presumed to be an insider who will receive information regarding the company before it is made public."

Of course, the rule states only a presumption, but the presumption is supported, not rebutted, by the facts here. The record establishes that, in spite of the rejection by Air Brake of its original merger proposal, Crane voluntarily thereafter acquired the status of a 10% holder; that it was informed on March 4 of the proposed Air Brake-Standard merger and its ranking officer remarked that for Crane to be a stockholder of Standard would be an "impossible situation"; that nevertheless Crane thereafter issued its tender offer, and that even after Standard's unexpected manipulative acts of April 19 it purchased over 490,000 shares of Air Brake —with the knowledge that either Standard would win the fight and Crane would be "forced" to sell, or that it might reap a speculative harvest on the almost certain (and ultimately actual) rise in the price.

To describe these facts and events it is not necessary to hold—and no holding is made—that Crane's acquisition of Air Brake stock was either illegal or unethical. But the recital does lead to the conclusion of *possibilities* of speculative abuse inherent in the situation. We are entitled, of

course, to take into consideration not only the facts, but the reasonable inferences which may be drawn from them. A realistic estimate of the inferences consequent to such facts is found in the statement of the then chairman of the Securities and Exchange Commission in Hearings Before the House Committee on Interstate and Foreign Commerce, 90th Cong., 2d Sess. (on H.R. 14475 and S. 510, at p. 22, July 1, 1968):

> "There has been enough experience in the past 2 years for any sophisticated takeover bidder to know that, unless management joins him, management will seek another partner and that other partner probably will make a slightly better offer. We have the feeling that many of these people are doing it for the short-term gain, or, to use the vernacular, to make a fast buck. We have a number of variants of that. We have a situation where almost overnight [a] particular individual or company made several millions of dollars in a situation of this kind.
>
> "We have the feeling that some of these offers are made only to initiate that activity."

We find support for our view of the matter in the decision of the Court of Appeals of this Circuit in Newmark v. RKO General, Inc., supra. That suit involved a merger between Frontier Airlines, Inc. and Central Airlines, Inc. RKO controlled Frontier during the times in question. After provisional agreement had been reached as to merger of the airlines (but before public announcement or stockholder approval) RKO contracted to buy 49% of Central's outstanding shares and $500,000 of its convertible debentures. The merger agreement provided for the exchange of Central for Frontier common. RKO exercised various rights of control as majority holder of

Frontier and a controlling stockholder of Central. In addition, RKO had an option to cancel in the event that the subsidy awarded by the CAB to the surviving airline was inadequate in RKO's "good faith judgment." The merger agreement was approved by the stockholders, by the CAB and creditors. RKO then consummated its purchase of Central securities. The merger agreement was filed and Central's securities were exchanged for Frontier's. The District Court held that the conversion rendered RKO liable under § 16(b). In affirming, the Court of Appeals remarked at the outset:

> "That RKO's heart may have been pure and its motivation noble matters not. The significant factor is whether RKO *could have* reaped a speculative profit from the 'unfair use of information * * * obtained * * * by reason of [its] relationship to [Central]'." (Emphasis in original). 425 F.2d at 353.

The Court's answer was affirmative. It is true that the Court—properly—placed emphasis on the facts that RKO controlled Frontier, had knowledge of the merger, and had a contract right to cancel the agreement, and that its option to purchase Central securities at a fixed price put it in ideal position to profit from an anticipated rise in the price of the stock—facts not present in the instant case. However, exceptional as such facts are, at least in combination, they were not elements sine qua non to the finding. Rather, they merely underpinned, although emphatically, the opportunity for speculative abuse which there existed.

Here Crane, although it did not possess the array of control powers exercisable by RKO, nevertheless knew that the probabilities were, from the time of Air Brake's rejection onward, that Air Brake would "seek another partner

and that other partner" would "probably . . . make a slightly better offer." After March 4 it knew this to a certainty and, although it quite rightly points out that it could not have anticipated Standard's manipulation of April 19, it nevertheless purchased over 490,000 shares of Air Brake in a period of more than a month thereafter.

Furthermore, aside from the fact that any party in Crane's position could reasonably have inferred from the dynamic pattern of take-over fights that it would either win control or be in a strong position to sell at a profit, there were also significant ways in which Crane could influence the course of events. For example, it could easily affect the exchange ratio of the merger by the terms of its own tender offer. It controlled the timing of its offer and had the opportunity to improve it with resultant effect on the ultimate terms of merger between Air Brake and Standard. Such power fits within the District Court's rationale in *Newmark* (294 F.Supp. 358, 365 (S.D.N.Y. 1968)) that an insider who "could influence the speed and timing of the merger, and possibly its outcome" may be liable under § 16(b). It must constantly be remembered that our search is not to determine whether Crane intended these results, but whether they were possibilities which inhered in the situation. We hold that they did, and that § 16(b) is applicable if Crane's transactions constituted purchases and sales within the meaning of the section.

B. *Were there purchases and sales?*

No elaborate analysis is necessary to answer this question. Without determining at this point whether, as Crane argues, Standard's acts "forced" Crane to sell so that Standard cannot recover, there can be no doubt that Crane's transactions were purchases and sales which would

ordinarily be covered by § 16(b). Crane does not dispute that its acquisitions of Air Brake stock were purchases, and consequently we need to consider only (1) whether the conversion of Crane's Air Brake stock constituted either a purchase of Standard stock or sale of Air Brake, and (2) whether under any circumstances Crane's sale for cash of Standard stock was not a sale of stock purchased within six months.

In Blau v. Lamb, supra, it was held that the conversion of preferred for common stock of the same company was not a sale under § 16(b). But the doctrine of "economic equivalence" formulated there is applicable only to the exchange of securities of a single issuer, a case not before us. To the contrary, "sales or purchases [as here] by an insider of his issuer's securities for cash, *the securities of a different company*, or other property are within the reach of Section 16(b) . . ." Blau v. Lamb, 363 F.2d at 523, as quoted in Newmark v. RKO, supra, 425 F.2d at 354. (Emphasis added in *Newmark*).

The question of whether conversion of Crane's Air Brake stock constituted a sale of Air Brake or purchase of Standard is decided by the rationale of *Blau*, and the specific ruling of *Newmark* which held that the conversion of RKO-held securities constituted a sale within the meaning of the section. Accordingly, we hold that the conversion of Crane's Air Brake stock into Standard stock constituted a sale of Air Brake to be matched against its cash purchases of that stock within a period of six months prior to the date of conversion.

IV.

The Effect of the Court of Appeals' Decision in Crane v. American Standard

A. *The question of forced sale*

We have earlier reviewed the history of the litigation commenced by Crane against Standard growing out of Standard's acts of April 19, and have recited the Court's observation that Standard's behavior "placed Crane in a situation comparative to that of the dissenting shareholders in Vine v. Beneficial Finance Co., 374 F.2d 627 (2d Cir. 1967, cert. denied 389 U.S. 970, 88 S.Ct. 463, 19 L.Ed.2d 460 (1968) for here, as there, plaintiff was forced to become 'a seller under the Act.'" (419 F.2d at 794). Crane strenuously argues that, even if it is determined that § 16(b) is applicable to its transactions—that is, that an opportunity for speculative abuse was inherent in those transactions, and they constituted purchases and sales within six months—nevertheless the holding of the Court of Appeals in Crane v. American Standard estops Standard from recovery.

It is contended that the Court of Appeals "found" Crane to have been a forced seller in the precise circumstances at hand, and that, under the doctrine of collateral estoppel, this finding binds Standard and precludes it from prevailing. Crane adds that the equitable doctrine preventing a wrongdoer from profiting from his own wrong stands as a further bar. At first blush there is great appeal in this rationale. For if it is true that the Court of Appeals has already found that Standard's illegal acts forced Crane to sell, then to allow recovery by the very party that forced the sale appears harsh. But there are a number of reasons why the rationale is not sound and the defense fails.

In the first place, in spite of the words used, there is some doubt whether the Court of Appeals "found" Standard's acts to have caused Crane to become a forced seller—at least if the word "found" is intended to mean "found as a fact," which it must to invoke the theory of collateral estoppel. The first such doubt is raised by other words in the opinion itself. For, in spite of the apparently unconditional language quoted above, the Court at the conclusion of its opinion seems to have qualified its determination. Thus, in remanding the case to the District Court, the Court states:

> "The manipulation *may* be found to have deprived Crane of success in its tender offer in the free market to which it was entitled . . ." (emphasis added).

Aside from the fact that Crane itself, in its petition (in Crane v. American Standard) for certiorari to the United States Supreme Court, argued that a more positive ruling by that Court would eliminate the "need" on remand "for proof that the manipulation deprived Crane of success in its tender offer" (Crane petition, June 2, 1970, p. 17), the remand language of the Court of Appeals surely diminishes the claim that that Court "found" Standard's acts unconditionally to have caused Crane to become a forced seller.

This construction of the Court of Appeals opinion is supported by the decision of Judge Mansfield, on remand, in Crane Co. v. American Standard, Inc., 326 F.Supp. 766 (S.D.N.Y.1971). There Crane had argued that on the record it was entitled to summary judgment. In deciding that it was not, and that the question of damages must constitutionally be tried by jury because there remained issues of material fact, Judge Mansfield reviewed the history of the litigation. He emphasized that the Court of Appeals had

noted that Judge Ryan on trial "'denied relief with no extensive treatment of the market manipulation and fraud claims involving sections 9(a) (2) and 10(b) of the Act . . .'" Judge Mansfield then commented as to the Court of Appeals opinion (326 F.Supp. at 774):

> "Faced with a decision containing such summary findings on the market manipulation claims, the Court of Appeals indicated clearly in Judge Smith's opinion that, for purpose of equity *jurisdiction*, it would have reached the contrary conclusion and found the essential elements of a violation of § 9(a) (2) and § 10(b) on the basis of Standard's buying huge amounts of Air Brake stock at $50 in the open market and on the same day making substantial off-market sales at about $44 to friendly institutional investors. This language should not be construed, however, to read that as a matter of law no reasonable jury could have found that Standard had not violated the above sections of the securities laws." (emphasis added).* * * In the absence of specific findings by Judge Ryan with respect to the claims based on §§ 9(a) (2) and 10(b), which would have been upset only if found by the Court of Appeals to be 'clearly erroneous,' Rule 52(a), F.R.Civ.P., the Court of Appeals concluded that on the record before it, it would have inferred the requisite motive and intent 'from the circumstances of the case,' 419 F.2d 794. This is a far cry from finding that as a matter of law motive, intent and willfulness *must* be found on this record or that it would reject a jury finding to the contrary." (emphasis in original).

And later (at 776):

> "As we view it the Court of Appeals did not hold that a jury, after observing the witnesses and ap-

praising their credibility, would be precluded from deciding issues of intent, motive and willfulness *contrary to the inferences drawn by it*, for the purposes of equitable relief, without benefit of such personal observation of the witnesses." (emphasis added).

B. *The Estoppel Defense*

Assuming, arguendo, nevertheless, that the Court of Appeals decision is properly construed as "finding" Crane to be a forced seller, the defense still must fail.

In the first place, the issue in Crane v. American Standard was not the same as here. There the court was called on to determine whether Crane had *standing* as a seller under §§ 9(a) (2) and 10(b) of the Act, sections of the statute with which we are not concerned here. In analogizing Crane to the forced seller in Vine v. Beneficial Finance Co., the Court of Appeals made it clear that it viewed Crane as having standing to sue for damages resulting from manipulative acts directed against it. Such a holding, however, is no determination of the quite different question whether Crane was a "forced seller" under § 16(b), or whether, if its status resulted from Standard's acts, that status or those acts would preclude recovery of Crane's short swing profits in Air Brake.

Second, assuming that, under the rule of *Newmark* and the holding above in this case, the conversion of Crane's Air Brake stock into Standard stock is the event which constituted a sale by Crane, then Standard's acts did not cause, much less force, the sale within the meaning of § 16(b). If causation be measured, as it classically is in analogous situations, by a "but for" test, it cannot be said that the conversion would not have occurred "but for" Standard's acts, since a conversion could (and probably

would) have occurred just as well whether Standard won the battle without manipulation, or even perhaps (though it need not be decided), if Crane had won.

Third, if the sale be regarded as taking place when Crane actually sold its Standard stock for cash, there is no showing (nor any holding by the Court of Appeals) that Standard's acts forced Crane to sell *when it did*—that is, either within six months of its original acquisition of the stock or within six months of the conversion. If Crane had held for the longer of these periods it could not be liable under any theory. While it is argued—and the Court of Appeals approved the argument—that Crane, as a chief competitor of Standard, would be forced to sell its Standard stock to avoid the impact of the antitrust laws, there is no evidence whatever to support the inference that that sale had to be made within six months. It is equally reasonable to infer either that Crane could have held the government at bay for six months or accepted a decree or arrangement which permitted the sale of its stock after that period expired. In any event, and without hypothesizing whether such possibilities were real, there is a fatal deficiency of evidence that the *timing* of the sale—a critical element—was caused by Standard's acts or that the Court of Appeals found that it was.

Up to now we have discussed the elements of collateral estoppel. It may be added that, in view of the therapeutic aims of § 16(b), the courts do not favor the defense of equitable estoppel, also relied on by Crane, in § 16(b) cases. See, e. g., Magida v. Continental Can Company, 231 F.2d 843 (2d Cir. 1956), cert. den. 351 U.S. 972 76 S.Ct. 1031, 100 L.Ed. 1490 (1956); Abrams v. Occidental Petroleum Corporation, 323 F. Supp. 570, 582 (S.D.N.Y.1971); Volk v. Zlotoff, 285 F.Supp. 650, 655-656 (S.D.N.Y.1968);

Jefferson Lake Sulphur Co. v. Walet, 104 F.Supp. 20 (E.D.La.1952), aff'd 202 F.2d 433 (5th Cir. 1953), cert. den. 346 U.S. 820, 74 S.Ct. 35, 98 L.Ed. 346 (1953).

We conclude, therefore, that Crane's defense based on the Court of Appeals decision in Crane v. American Standard is ineffective here; that Crane is liable under § 16(b), and that Standard is not estopped from recovering such damages as it may prove.

This conclusion is consistent with other decisions in which recovery has been allowed against "forced" sellers of sorts. In Western Auto Supply Company v. Gamble-Skogmo, Inc., 348 F.2d 736 (8th Cir. 1965), the Court upheld recovery of short swing profits under § 16(b) even though the sale which produced the profits was required by a consent antitrust decree. The defendant argued that, because its action was "compelled by the Government's antitrust action," § 16(b) should not apply. The Court brushed aside the contention, remarking: "In any event, the mere pendency of an action would not weigh to give the term 'sale' any other than its ordinary meaning." *Id.* at 742. The case is directly in point here, for if the *actual* pendency of antitrust litigation is not construed as removing a resultant sale from the coverage of § 16(b), surely the mere possibility of such litigation, as here, is not effective to do so.

Alloys Unlimited, Inc. v. Gilbert, 319 F.Supp. 617 (S.D.N.Y.1970), held that recovery was proper under § 16(b), even though the sale of securities which had been pledged as collateral was not made by the defendant (owner of the stock) but by the bank-pledgee. The defendant argued that the liquidation of the stock was not a "sale" within § 16(b) since it was involuntary on his part and did not represent the type of speculation against which

§ 16(b) was directed. Judge Mansfield rejected that view, holding that the transaction was one which permitted the opportunity for speculative abuse, since a trader could bring about such a sale deliberately by defaulting on the underlying loan.

In Abrams v. Occidental Petroleum Corporation, supra, 323 F.Supp. 570, a case having many elements in common with the instant action, the defendant (Occidental), as here, acquired stock in a company it sought to take over. Occidental, like Crane, was unsuccessful in the take-over battle, and upon merger of the target company with Occidental's rival, Occidental received, for its target company stock, stock in the merged company, which it sold. Occidental "sought from the SEC a new rule, Rule 16(b)—11" which would have exempted the transaction from the operation of § 16(b). The SEC declined to issue the rule. In the court proceedings Occidental argued that its acquisition of the merged company's stock was "involuntary," but Judge Palmieri rejected the contention and found Occidental liable under the section.

Our conclusion reaches a proper result. It leaves each party free to proceed with whatever rights it has against the other. As nothing in the rulings of the other courts in Crane v. American Standard prevents such recovery as is warranted here, so nothing in this opinion stands as a barrier to Crane's rights in other litigation against Standard. Each company's ultimate recovery will be determined, as it should be, on the merits of its respective claim and the particular section of the Act under which it is brought.

To conclude: The motion of Crane Co. for summary judgment against American Standard, Inc. is denied. The motion of American Standard, Inc. for summary judgment against Crane Co. as to liability is granted.

It is so ordered.

Appendix C—Opinion of the District Court

SUPPLEMENTAL OPINION

[July 6, 1972]

On October 12, 1971, we issued an opinion (CCH Fed. Sec.L.Rep. ¶ 93,237) granting Standard's cross-motion and denying Crane's motion for summary judgment in this action for the recovery of short-swing profits under § 16(b) of the Securities Exchange Act of 1934. On the following day the Court of Appeals of this Circuit decided Abrams v. Occidental Petroleum Corp., 2d Cir., 450 F.2d 157. Because the *Occidental* court summarily dismissed the complaint on a record which bore marked similarities to the case here, our opinion of October 12 was withdrawn to permit consideration of the possible impact of *Occidental* on the issues before us.

Although we expressly limited the scope of supplemental briefs to the impact of the *Occidental* case, Crane nevertheless has raised several new issues which, even construing our instructions most liberally, have no relation to the Second Circuit's decision. However, in the interests of judicial economy, we accept the responsibility for determining what amounts to a new motion for summary judgment.

We conclude that *Occidental* does not bar our earlier disposition of the case and that the further grounds newly pressed by Crane are without merit.

THE IMPACT OF OCCIDENTAL

Our earlier opinion devoted itself to the following questions:

1. Whether the facts established that an opportunity for speculative abuse by Crane existed.

2. If so, whether Crane's dealings in Air Brake and Standard stock constituted purchases and sales within the meaning of the Act.

3. If so, whether the decision in Crane v. Westinghouse Air Brake Company, 419 F.2d 787, 792-799 (2d Cir. 1969), constituted a binding determination that the merger resulted from Standard's illegal market manipulation.

We answered the first two questions in the affirmative and the third in the negative.

Since *Occidental* related in no way to the third issue listed above, there is no need to reconsider the validity of our decision on that point, and indeed, for purposes of the present argument, Crane accepts the ruling without agreeing to it.

There remains for determination the effect of *Occidental* on our decision that the facts here presented Crane with an opportunity for speculative abuse and that Crane's dealings in the Air Brake-Standard stocks constituted purchases and sales within the meaning of the Act.

A brief sketch of *Occidental* is in order. There, as here, the claims were asserted on behalf of what we described in our earlier opinion as the successful suitor of a target corporation against the unsuccessful suitor.[1] New Kern

[1] Kern County Land Company (Old Kern) was the target corporation in the *Occidental* case. Occidental's rival for the take-over of Old Kern was Tenneco, Inc. The agreement ultimately reached between Tenneco and Old Kern provided that, in exchange for the transfer of Old Kern's assets to a newly organized wholly-owned subsidiary of Tenneco known as New Kern, each share of Old Kern would be exchanged for a share of preference voting stock of Tenneco convertible into shares of its common stock. For the purpose of simplicity, we refer to New Kern in all instances in which the corporation actually referred to might be either New Kern or Tenneco.

was the happy winner; Occidental the sad loser. They stand as counterparts of Standard and Crane in this case.

Occidental made the first tender offer for the target corporation, Old Kern. In a pattern which seems all but inevitable in such matters and is for all practical purposes identical to the rivalry here between Standard and Crane for the control of Westinghouse Air Brake, Old Kern resisted Occidental and ultimately reached agreement with New Kern.[2] As in our case, the unsuccessful competitor—Occidental—had become a 10% stockholder of the target corporation, and (as here, too) its holdings irrevocably entitled it to shares of the successful competitor—New Kern—by virtue of the merger agreement between the target and New Kern. The *Occidental* scenario, however, included an embellishment not found in our script: While the merger plan was being formulated, Occidental entered into an agreement with its competitor granting the latter an assignable option to buy the stock Occidental would receive as a result of the merger.

The merger was consummated and in due course, on December 11, 1967,[3] Occidental tendered its Old Kern stock for the exchange stock, New Kern's assignee exercised its option to buy, and Occidental sold the stock at a substantial profit over its investment. The § 16(b) suit followed.

New Kern sought judgment on two grounds: First, that Occidental had "sold" its Old Kern shares when it became irrevocably entitled on August 30, 1969 to the exchange stock, and second, that the option agreement of June 2, 1967 constituted a "sale" by Occidental of the Old Kern shares that had been or would thereafter be ac-

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[2] See foonote 1 above.

[3] Occidental had become a 10% stockholder of Old Kern by May 4, 1967, and its last purchases of Old Kern stock appear to have occurred before June 8.

quired. The Court of Appeals rejected both contentions and dismissed the complaint. As to the first argument, the court extended to the receipt of exchange stock of *another* company (in a merger) the test of Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), cert. den. 385 U.S. 1002, 87 S.Ct. 707, 17 L.Ed. 2d 542 (1967), as to the conversion of stocks of *one* company, i. e., that in determining whether a conversion constituted a purchase or sale the court "would look to the question whether the conversion could have lent itself to speculative abuse." As the opinion stated:

> "We see no reason why his same principle should not apply when the question is whether the receipt of securities of another company, in a transaction which the 'insider' did not arrange and in which all stockholders were entitled, indeed here were forced, to participate, constitutes a 'sale.' " *Occidental*, supra, 450 F.2d at 162.

As to the second (option) claim, the court applied its "established rule" that the mere grant of an option to purchase is not a sale for purposes of § 16(b).

We are primarily concerned with *Occidental's* ruling that no opportunity for speculative abuse inhered in that case, and turn to a further analysis of the opinion on that point.

The key to the court's holding lies in its distinction between the facts in Newmark v. RKO General, Inc., 425 F.2d 348 (2d Cir.), cert. denied, 400 U.S. 854, 91 S.Ct. 64, 27 L.Ed.2d 91 (1970), and those presented in *Occidental* itself. In *Newmark*—relied on both by the plaintiffs in *Occidental* and by Standard here—the court had found § 16(b) liability resulting from the merger-triggered conversion of securities. The *Occidental* court found compell-

ing differences between *Occidental* and *Newmark*. The telling language, for our purposes, follows:

> "While the *RKO General* decision does assist appellees to the extent of its holding that an exchange pursuant to a merger *may be* a 'sale,' the indispensable predicate to the holding that the particular exchange there at issue was within § 16(b) was the finding that RKO's knowledge of the impending merger coupled with the ability to control it involved the possibility of speculative abuse with which § 16(b) meant to deal. (emphasis in original).
>
> "Appellees have failed to demonstrate any counterpart of this with respect to Occidental. It is urged that Occidental possessed the 'inside information' that Old Kern might well respond by arranging a 'defensive merger' and that, if the terms were sufficiently favorable, Occidental would not try to top them. But, in contrast to *RKO General* where the buyer knew of the imminent announcement of a merger that would enhance the price of the shares and could largerly control its course, Occidental had no knowledge what Old Kern would do, and certainly did not know that Old Kern would be able to arrange an exchange offer exceeding Occidental's bid by $20 per share, with the added benefit of freedom from capital gains tax. We fail to see the possibility of speculative abuse in a situation where such an offeror simply declines to make a still higher offer or to attempt to block a transaction which it regards as advantageous to all the stockholders including itself." 450 F.2d at 163.

If the case at hand turned solely on the question whether Crane's position offered the opportunity for speculative

abuse, the *Occidental* court's rationale might well raise serious doubts as to whether Standard's motion for summary judgment could be granted, although it is far from clear that Crane did not have "the ability to control" characteristic of "Newmark" vulnerability to § 16 (b). We need not wander through the thickets of an extended analysis on that point, however, because a compelling difference exists between *Occidental* and the case before us: that is, that all of Occidental's cash purchases and its subsequent cash sales occurred more than six months apart (June 8—December 11), whereas Crane's acquisition and disposition of its shares *for cash* occurred within five months (January 25—June 7) of its becoming a 10% stockholder of Air Brake. Indeed, the *Occidental* plaintiffs made no claim based on Occidental's *cash* sales (because they occurred beyond the six-months statutory period), but complained rather that Occidental's receipt of the exchange stock on merger and its execution of a "call" option were "sales" as a matter of law. Standard's complaint against Crane, on the contrary, *is* based (Par. 9) on Crane's cash sales, matched against its acquisition of the Air Brake common.

Accordingly, rather than falling in the "uncovered" category carved out by Occidental, Crane's purchases and ultimate cash sales constituted what Chief Judge Friendly characterized as

> "... a garden-variety purchase and sale ... within six months, the situation(s) to which Congress' attention was primarily addressed when it enacted § 16(b) ... The only way to avoid § 16(b) liability in such cases is to see to it that the matching transaction is postponed beyond the six months period, although one day is enough to do the trick." *Occidental*, supra, 450 F.2d at 162.

It is true that in our earlier opinion we placed stress on the issue of speculative abuse: because the parties themselves posited in the alternative the question posited in *Newmark* (and later in *Occidental*)—whether Crane's acquisition of the exchange shares through the merger constituted a "sale." For the purposes of ruling on that alternate theory it was necessary to analyze at length Crane's opportunity for speculative abuse.

However, we also pointed out in our earlier opinion that one of the two questions before us was "whether under any circumstances Crane's sale for cash of Standard stock was not a sale of stock purchased within six months" (p. 1161 of opinion), and we concluded, in answer to Crane's assertion that its cash sale was "forced" by Standard, that ". . . if the sale be regarded as taking place when Crane actually sold its Standard stock for cash, there is no showing (nor any holding by the Court of Appeals) that Standard's acts forced Crane to sell *when it did*— that is, either within six months of its original acquisition of the stock or within six months of the conversion (p. 1163 of opinion).

Our use of the conditional phrase "if the sale be regarded as taking place when Crane actually sold its Standard stock for cash" did not imply any doubt that the cash sale was a critical event as a matter of law, but only that Standard argued the alternate theories of a sale on conversion as well as a cash sale. There could, of course, never have been a doubt that the cash sale was a "sale." The only question raised *as to the cash sale* was whether it was "forced" by Standard. We have ruled that it was not, as we have stated above, *Occidental* does not affect that ruling.

Accordingly, we find that the holding in *Occidental* requires no change in our earlier opinion, which we now reaffirm.

We proceed to the issues raised by Crane's new motion for summary judgment.

THE NEW MOTION

Crane's new motion is based on the contention that its sale of the Standard preference stock it received in the merger cannot subject it to § 16(b) liability because during the six-day period between the merger and its sell-out the stock was temporaily an "exempted security" and because it was not effectively registered under § 12 of the Exchange Act.

Standard claims that these contentions are erroneous as a matter of law. Nevertheless, it argues that it is altogether irrelevant whether the Standard *preference* stock was exempt or nonregistered because the preference was convertible into Standard *common* stock which was admittedly registered and nonexempt.

Although we agree with Standard that Crane's argument as to the exempt status of the preference stock is incorrect, we need not treat that contention at length, since we also find merit in Standard's second point—that the status of the preference stock as to exemption or registration is irrelevant. It is appropriate to comment, however, that we find Crane's "exemption argument," relying as it does on technical rules of the Securities and Exchange Commission (which regulate the mechanics of trading on the Stock Exchange) to cull out a general exemption from § 16(b), highly questionable.[4] For example, Rule 12b-6,[5] which Crane contends establishes an exemption, in fact

[4] In *Occidental*, Chief Judge Friendly discussed briefly Occidental's efforts to secure analogous benefits under § 16(b) by arranging to have the new Tenneco prefence shares remain in an unregistered statute through the expiration of the six months (450 F.2d at 160, n. 6). We are aware that he stated that he was not ruling on such a device, but his remark that "*[h]opefully* this would avoid § 16(b) liability" (emphasis added) may indicate some doubt as to the viability of the theory.

(footnote 5 on following page)

merely specifies the date on which a registration statement is to be deemed effective; it does not create an exempted security, as defined by § 3(a) (12) of the Act. Again, Rule 12a-5 [6] is solely intended to provide a temporary exemption from one section of the Act (§ 12(a)) and for a restricted purpose (i.e., the "substituted security shall be temporarily exempted from the operation of section 12(a) to the extent necessary to render lawful transactions therein on an issued or 'when-issued' basis . . ."). We agree with Standard that the above rules carve out, at best, only limited exemptions and not general exemptions from the entire Act or from § 16 in particular. At the very best, Crane's argument as to the effect of the cited rules is doubtful; and the doubt should be decided against Crane, since to construe

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[5] SEC Rule 12b-6 provides in pertinent part:

"A class of securities with respect to which a registration statement has been filed pursuant to section 12 of the Act shall be deemed to be registered for the purposes of sections 13, 14, 15(d) and 16 of the Act and the rules and regulations thereunder only when such statement has become effective as provided in section 12, and securities of said class shall not be subject to sections 13, 14 and 16 of the Act until such statement has become effective as provided in section 12." 17 C.F.R. § 240.12b-6.

[6] SEC Rule 12a-5 provides in pertinent part:

"Subject to the conditions of subparagraph (2) of this paragraph, whenever the holders of a security admitted to trading on a national securities exchange (hereinafter called the original security) obtain the right, by operation of law or otherwise, to acquire all or any part of a class of another or substitute security of the same or another issuer, or an additional amount of the original security, then:

"(i) all or any part of the class of such other or substituted security shall be temporarily exempted from the operation of section 12(a) to the extent necessary to render lawful transactions therein on an issued or 'when-issued' basis on any national securities exchange on which the original, the other or the substituted security is lawfully admitted to trading; . . ." 17 C.F.R. § 240.12a-5(a)(1)(i).

the rules to establish the exemptions claimed would utterly defeat the monolithic purpose of § 16: to take the profit out of the insider dealing.

We now proceed to Standard's "convertibility argument."

Relying primarily on the decision of the Court of Appeals of this Circuit in Chemical Fund, Inc. v. Xerox, 377 F.2d 107 (1967), Standard claims that the test as to whether the holder of a convertible security is directly or indirectly the "beneficial owner of more than 10 per centum of any class of any equity security"[7] is to be determined by "the total percentage of common stock which a holder would own following a hypothetical conversion" of the convertible stock. *Chemical*, supra, at 110. Since it is undisputed that Crane would have owned more than 10% of Standard's common stock had it converted its preference stock, under Standard's view the "exemption argument" would fall by the wayside and Crane would be liable even though the preference stock was not registered or temporarily exempt.

Not surprisingly, Crane has anticipated Standard's "convertibility argument" and contends that the hypo-

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[7] Section 16(a)-(b), 15 U.S.C. § 78p(a)-(b), provides in pertinent part:

"(a) Every person who is directly or indirectly the beneficial owner of more than 10 percentum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file [specified reports] of the amount of all equity securities of such issuer of which he is the beneficial owner. . . .

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer. . . . Suit to recover such profit may be instituted . . . by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer . . ."

thetical conversion test of liability is inapplicable to the facts of this case; and that it is applicable only when the convertible stock is the "equivalent" of the underlying stock. Crane maintains that the Standard preference and common were not "equivalent" because of differences between them as to dividend and liquidation rights, for example.

While the question whether the hypothetical conversion test of liability is applicable in *all* cases involving convertible issues has never been squarely determined, nevertheless the only decisions which bear on the subject have in fact applied the test. Chemical Fund v. Xerox, supra; Simon v. Sunasco, CCH Sec.L.Rep. ¶ 92,547 (S.D.N.Y. 1970). We find no reason not to apply the test on the facts of this case. The *Chemical Fund-Sunasco* rationale is consistent with the overall purpose of § 16 and with relevant SEC regulations. On the other hand, the theory proposed by Crane, whatever intriguing intellectual appeal it may have, reaches a result at cross purposes with § 16 which we decline to adopt unless it is validated by higher authority.

Since the genesis of the hypothetical conversion test was Chemical Fund v. Xerox, we begin our analysis there. The issue, as stated by Chief Judge Lumbard, was "whether Chemical Fund, the owner of more than ten percent of Xerox Convertible Debentures, is liable for short-swing trading profits as a 'beneficial owner of more than 10 percentum of any class of any equity security' within the meaning of section 16 of the the Securities Exchange Act of 1934 . . ." (at 108).[*] In holding that it was not, the court reasoned as follows:

> "Thus the question is: are the Debentures by themselves a 'class of any equity security,' or does

[*] In *Chemical*, the Fund held more than 10% of the Convertible Debentures but less than 10% of the common following a hypothetical conversion. Here, Crane would own more than 10% of the Standard common upon conversion.

the class consist of the common stock augmented, as to any beneficial holder in question, by the number of shares into which the Debentures it owns are convertible? We think that the Debentures are not a class by themselves; the total percentage of common stock which a holder would own following a hypothetical conversion of the Debentures it holds is the test of liability under section 16(b). The history of the legislation, the stated purpose of the Act, and the anomalous consequences of any other meaning all support this conclusion." *Chemical Fund*, supra, 377 F.2d at 110.

In the case at hand, if Crane had converted its 740,311 Standard preference shares it would have been the holder of 15% of Standard's common stock.

Crane attempts to distinguish *Chemical Fund* on the ground that, unlike a debenture (the convertible security there), which is defined as an "equity security" only because of its convertible nature,[9] the Standard preference stock is an "equity security" regardless of its convertibility. Crane argues that, therefore, the preference shares are "a class by themselves" and that resort to Crane's hypothetical position in the underlying common stock is not warranted by the rationale of *Chemical Fund*.

We do not think that such an analysis is consistent with the reasoning of the Second Circuit. In the first place, nothing in the opinion suggests that the court intended its rule to apply any the less to convertible preferred stock (which is defined in the Act as an equity security both in its own right and because convertible to another equity security) than to convertible debentures (which are defined

[9] Section 3(a) (11), 48 Stat. 884 (1934), 15 U.S.C. § 78c(a) (11).

as equity securities solely because of their convertibility to an equity security). Secondly, Crane's rationale would lead to the most anomalous results—results the Court of Appeals clearly sought to avoid. *Chemical Fund*, supra, 377 F.2d at 111. For example, as Standard points out, under Crane's theory the closer the holder of the convertible issue is to having a present equity ownership, the *more* likely he is to escape liability under § 16. A holder of a senior debt security convertible into more than 10% of the issuer's common stock would be subject to § 16(b) (*Chemical Fund*), while a holder of an unregistered preferred voting stock convertible into more than 10% of the common would not be liable!

Furthermore, our construction of the meaning of *Chemical Fund* is supported by the SEC's action in promulgating revised Rule 16a-2 in *Chemical Fund's* wake. Rule 16a-2(b) reads:[10]

> "In determining for the purpose of section 16(a) of the Act whether a person is the beneficial owner, directly or indirectly, or more than ten percent of any class of equity securities, such person shall be deemed to be the beneficial owner of securities of such class which such person has the right to acquire through the exercise of presently exercisable options, warrants or rights or through the conversion of presently convertible securities."

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[10] Crane's argument that SEC Rule 16a-2(b) applies only to the reporting requirements of subdivision (a) of § 16 of the Act, and not to subdivision (b), which deals with liability for short-swing profits, is without merit. As Judge McLean pointed out in Simon v. Sunasco, supra, CCH Sec.L.Rep. at p. 98,510, the two sections are grammatically and legally interconnected:

> "The use of the word 'such' ties Section 16(a) and Section 16(b) together and makes it clear that the beneficial owner to whom Section 16(b) refers is the beneficial owner described in Section 16(a)."

It is significant that Rule 16a-2 does not use the words "class by themselves," nor does it make any distinction between securities which are "equity securities" in themselves, as here, and those which are equity securities solely because they are convertible into equity securities ("Chemical" securities). The Rule is broad and clearly controls the facts of this case. Therefore, applying the Rule, since Crane had "the right to acquire" more than 10% of Standard's common stock "through the conversion of presently convertible securities," Crane is deemed to have been the "beneficial owner, directly or indirectly, of more than ten percent" of the underlying Standard common.[11]

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[11] We disagree with Crane that for the purposes of § 16 a person may only be the beneficial owner of *either* the convertible or underlying stock. Whatever factual validity the assertion may have, SEC Rule 16a-2 states that a convertible security holder is *deemed* to be the beneficial owner of the underlying security. The inevitable consequence of Rule 16a-2 is that a person may be the "owner" of two securities—the convertible security and the underlying common stock—and that a person must comply with the statutory requirements as to *both* securities. This is implicit in Rule 16a-2's direction that

> "This paragraph [i. e., paragraph (b) of Rule 16a-2] shall not be construed to relieve any person of any duty to comply with section 16(a) of the Act with respect to any equity securities consisting of options, warrants, rights or convertible securities which are otherwise subject as a class to that section (of the Act)."

Thus, we think that this Rule requires a person to be subject to the requirements of § 16 either when he holds more than 10% of the original convertible security or when he holds more than 10% of the underlying security following a hypothetical conversion. As to convertible *debentures*, under the authority of *Chemical Fund* a holder would *only* be liable if, after a hypothetical conversion, he held more than 10% of the common stock.

Crane's reliance on SEC Rule 155 is misplaced. That Rule was promulgated to prevent issuers from employing the private placement of convertible securities as a vehicle to avoid complying with registration and disclosure requirements as to the underlying security. Its purpose was to *expand* the scope of liability under the registration provisions of the Act—not to *limit* liability under § 16. Crane's interpretation would fly in the face of the *Chemical Fund* rationale, as well as the more recent Rule 16a-2, which was promulgated with § 16 specifically in mind.

Under facts substantially identical to the present case, Judge McLean in Simon v. Sunasco, supra, CCH Sec.L.Rep. ¶ 92,547, found the *Chemical Fund* test, as well as Rule 16a-2(b), to be dispositive. There recovery was sought under § 16 (b) for profits allegedly realized by the defendant Sunasco through its acquisition pursuant to an exchange plan of CUC "special" stock (an unregistered, unlisted voting stock), the conversion of that stock into CUC common (which was registered and listed), and the simultaneous sale of the common. In denying defendant's motion for summary judgment, Judge McLean stated that the first issue to be decided was "whether Sunasco was the beneficial owner, directly or indirectly, of ten per cent of a class of equity security registered pursuant to Section 12, in other words, whether it was the owner, directly or indirectly, of ten per cent of CUC common stock . . ." (p. 98,510).

Relying upon the *Chemical Fund* case and what he termed the "substantially similar" Rule 16a-2(b), and after finding that the CUC special stock was "presently convertible" under the provisions of the exchange plan, Judge McLean concluded that Sunasco was the indirect owner of more than 10% of the common shares. However "unique" the provisions of the exchange plan may have been in *Simon*, we find the controlling facts here virtually indistinguishable from those presented to us. The crucial question here, as it was in *Simon*, is whether the holder had the "right to acquire" the common stock through the conversion of presently convertible securities. The special stock in *Simon* was no less "a class by itself" than the Standard preference stock. Furthermore, Judge McLean had no difficulty in applying the hypothetical conversion test despite the fact that the special stock was an "equity

security," both in its own right and as a convertible security.

We cannot agree with Crane that *Simon* is distinguishable on the ground that there was a "complete equivalence" of the CUC special stock and common stock, when Judge McLean, in specifically taking issue with the defendant who made the same contention, stated:

> "In *Blau*, the Court of Appeals said that there was 'economic equivalence' between the preferred and the common, that the conversion of preferred into common did not change the holders' 'investment position' . . . [Blau v. Lamb, 363 F.2d 507, 522 (2d Cir. 1966).]
>
> "In the present case, on the contrary, there certainly was a change in Sunasco's investment position. It acquired special stock. Within a few weeks or months thereafter, it converted special into common and sold the common simultaneously with the conversion, and realized cash, thereby making a 'trading gain.'" Simon v. Sunasco, supra, CCH Sec.L. Rep. pp. 98,511-12.

Crane further argues that, assuming arguendo it had the *status* of an insider of the Standard common stock by virtue of the conversion test, Crane's *transactions* in the preference stock are nonetheless shielded from § 16(b) liability because they involved the purchase and sale of exempted securities. Crane contends that, while it may be arguable that the owner of a convertible security also *owns* the underlying security, it is a wholly different thing to say that the sale of a convertible security also constitutes a *sale* of the underlying security.

We disagree. Crane's sole argument seems to run in the following syllogism: (a) § 16(a) refers to "direct" or "indirect" ownership; (b) § 16(b), which governs as to short-swing sales, contains no such language; (c) ergo, Congress did not intend that a direct sale of the convertible security should also be considered an indirect sale of the underlying security. We find the rationale unconvincing. First, as stated above in footnote 10, subsections (a) and (b) of § 16 cannot be read in isolation. The "beneficial owner" subject to subsection (b) liability for executing covered *transactions* ("purchase and sale or any sale and purchase") is the same beneficial owner referred to in subsection (a). Secondly, in *Simon*, Judge McLean had little difficulty in finding the defendant subject to subsection (b) liability despite the fact that some of the special CUC stock had never actually been converted or, in other words, that no *transactions* had actually taken place in that stock. In this argument Crane overlooks the whole thrust of the conversion test—that a holder of a convertible security may be subject to § 16(b) liability following a *hypothetical* conversion.[12]

[12] Crane's final argument—assuming arguendo that it, as owner of the Standard preference stock, was the beneficial owner of the underlying Standard common, nevertheless § 16 would not apply since that common stock was itself unissued, and therefore unregistered under § 12 of the Act, at the time of Crane's transactions in the Standard preference stock—is simply without merit. Crane's reliance on SEC Rule 12d1-1(a), which allows registration of an entire *class* of securities so that issuance of some shares can be delayed, is totally inappropriate to the question of § 16(b) liability. The fact that the Standard common stock was admittedly registered as a *class*, albeit not yet issued, is sufficient to subject Crane to the purpose and language of § 16 which applies to 10% holders "of any *class* of any equity security registered pursuant to Section 12." (emphasis supplied). It is not necessary that the particular shares held by the defendant be issued; it is sufficient if the class as a whole is registered.

We think the possibilities for speculative abuse are as great here, if not greater, than in *Simon*, supra. See Cook & Feldman, Insider Trading Under the Securities Exchange Act, 66 Harv.L.Rev. 612, 626 (1953). It seems to us that Crane's arguments would have the inevitable consequence of creating a loophole at odds with the purposes of § 16(b) by permitting the opportunity to trade in unregistered convertibles and derive all the advantages of the publicly traded underlying stock (See Meeker & Cooney, The Problem of Definition in Determining Insider Liabilities Under Section 16(b), 45 Va.L.Rev. 949, 960 (1959)), all the while being insulated from § 16(b) liability because of the convertible's unregistered status.

In sum, we think that Crane has woven an ingenious web of technical arguments which, at the best, raises doubts as to the construction of the statute and various SEC rules. But, as the Supreme Court has very recently stated in Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418, 424, 92 S.Ct. 596, 600, 30 L.Ed. 2d 575 (1972):

> "[W]here alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders."

Crane's motions for summary judgment are denied. Standard's motion for summary judgment is granted.

It is so ordered.